INTERNAL REVENUE SERVICE OPERATIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

FEBRUARY 6, 1987

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INTERNAL REVENUE SERVICE OPERATIONS

FRIDAY, FEBRUARY 6, 1987

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to call, at 10 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
FRIDAY, JANUARY 30, 1987

PRESS RELEASE #2
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A HEARING ON INTERNAL REVENUE SERVICE OPERATIONS

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will conduct a hearing on whether the Internal Revenue Service (IRS) is adequately prepared to meet the new challenges of tax reform. Specifically, the Subcommittee will review how well the IRS is handling this year's tax return filing season; the quality and availability of IRS Taxpayer Services; computer equipment availability, utilization and capacity, including the status of the Tax System Redesign project; implementation of the Tax Reform Act of 1986, including the W-4 form program; and recently amended penalty provisions. The hearing has been scheduled for Friday, February 6, 1987, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.

The Subcommittee will receive testimony from IRS Commissioner Lawrence B. Gibbs, Jr. He will be accompanied by the IRS Taxpayer Ombudsman, and the Assistant Commissioners for Returns and Information Processing, Computer Services, Tax System Redesign, Examination, Collection, and Inspection. In addition, the General Accounting Office will report on its investigation, conducted at the request of the Subcommittee, of the planned replacement of the IRS's communications processors; the efforts to extend the useful life of the IRS's mainframe computers; and the Tax System Redesign project.

In announcing the hearing, Chairman Pickle made the following statement: "In passing the Tax Reform Act of 1986, Congress tried to make our tax laws fairer. Now we must make sure that the IRS administers the law effectively and efficiently, and provides essential information to taxpayers in an adequate and timely manner. This hearing will be our first hard look at how well the IRS is responding to the changes mandated by tax reform and handling the 1987 work load. Of particular concern is the implementation of the new W-4 form and the availability of taxpayer services. Further, because of the IRS's increasing reliance on computers, the Subcommittee will focus on IRS's data processing operations and any computer-related problems which could adversely affect the IRS either in the short or long term. Finally, considerable work remains to be done to reduce last year's unacceptably high inventory backlogs of correspondence and adjustments, unpostables, and accounts receivable. I am requesting an update on IRS's inventory levels and information on what IRS plans to do to reduce these backlogs."

Details For Submission of Written Comments

Persons wishing to submit written comments for the printed record of the hearing should submit six (6) copies by the close of business, Thursday, February 26, 1987, to Joseph K. Dowley, Chief Counsel, Copmmittee on Ways an Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D. C. 20515.

SEE ENCLOSED FORMATTING REQUIREMENTS.

*****

Chairman PICKLE. I will ask the subcommittee to come to order. We will ask our guests if they will please take seats so that we might proceed. We have the prospect of a rather lengthy hearing today, and we are going to proceed at this point.

I want to make an opening statement, and Mr. McGrath will also make a statement.

First, I want to welcome our distinguished visitors and the witnesses who are with us this morning. I can tell you that we are taking a different view of the IRS today than we did 2 years ago, because 1985 was a rather disastrous season.

I do want to say though to the IRS that you had a better year in 1986, and we are very pleased to recognize that.

More Americans have contact with Internal Revenue Service than any other agency, and the financing of entire Federal Government depends on the Internal Revenue Service. Therefore, it is important that the IRS be a model of efficiency and fairness.

This morning we will be focusing on three main questions. First, what is being done to make sure that the 1987 filing season is fuily successful? Second, is the service taking the steps necessary to implement tax reform so that the 1988 tax filing season will run smoothly? Third, is the IRS restructuring its administrative and computer operations so it can meet increasing demands on the tax system? As we try to answer these questions today, we will be hearing testimony on several critical issues.

In the coming year the IRS will be under enormous public pressure to issue the tax regulations and guidelines necessary for implementing tax reform. The controversy around the issuance of the new W-4 form is a clear example of the problems that can arise. I can't help but observe—I notice the IRS had to rise a little early this morning, and you had to appear over at the other body at either 8 or 8:30 this morning. That is a rather early hour to be arising.

Maybe we ought to move our hours up a little earlier, Commissioner, to 8, and then you would have to go over to the other body at 7, even before the dawn has come. But at any rate, we are glad we are airing these questions.

When Congress voted to require the filing of the W-4 form, I don't think anyone had in mind making taxpayers go through the process of estimating all, I want to emphasize, "all" of their income or all of their deductions and credits for the coming year.

Frankly, I don't see how we can expect people to submit their casualty and theft losses, but that is being required. How do you predict that a burglar is going to break into your house?

How are you going to predict what your payment level will be if you are divorced or you are suddenly alone in this world? The form is too complicated, if we try to estimate "all" the income deductions and credits.

I hope that the Commissioner can explain what the Service is doing to straighten this matter out, because it is essential that the IRS be able to respond to this challenge. If a solution is not found in a hurry, I am afraid taxpayers will get disgusted with it and perhaps ignore the new form. If that happens, our hopes of increasing compliance rates to the tax reform will be down the drain.

Mr. Commissioner, before you appear I personally want to say that I do not think that the Internal Revenue Service per se is the villain in this whole process. The Congress mandated, in effect, a new W-4 form when we changed the tax form.

We also mandated that you be 90 percent accurate or suffer a penalty. Those are pretty hard requirements, and I think we have to ask ourselves, did we really intend exactly that. That is something we have to work on with you.

As far as the public confidence in tax reform goes, we may really have fallen out of the saddle before the horse has even gotten out of the chute. We hope that is not the case, but that is a possibility.

In addition, the IRS must be ready to respond to taxpayers' needs for assistance in figuring out how to comply with the new law under tax reform. Under our system of voluntary tax assessment, it is unreasonable, or to rephrase it, it is unreasonable to expect some people to hire a lawyer or an accountant to get answers to the most basic tax questions.

It is absolutely unacceptable not to even answer the phone when a taxpayer calls asking for help in paying his or her taxes.

On another critical point, the Service must never lose sight of its basic mission—to collect taxes. Today, the amount of tax dollars sitting in IRS accounts receivable, waiting to be collected, is over $48 billion. This, too, is unacceptable.

We have to ask ourselves if the level in 1982 was $25 billion in receivables, and today it is over $47 billion, why is that, and what is the answer to it?

We all must recognize that the IRS is absolutely dependent on its computers to administer the tax system. I am troubled by the continued difficulty the Service is having in upgrading its data communications by replacing the front-end processors in its service centers.

More than 14 months ago, this subcommittee heard testimony that the front-end processors represented the weak link in IRS's computer systems. We were told they needed immediate replacement. And, yet, the old ones are still in place. Where are the replacements? Are they in place, or when will they be in place? What can we depend on?

Finally, over the next 6 or 10 years, the IRS is faced with restructuring its entire computer system so as to better use its resources and serve the public. Yet, recent events raise real questions about whether the IRS has the resources, the discipline, and the support to meet its current workload demands, while also planning for and acquiring future state-of-the-art computer systems.

I hope that the IRS, the Treasury, OMB, and the Congress are prepared to meet the challenges of the future. Working together over the past 2 years we have made great strides, and the Internal Revenue Service has made great strides during the 1986 season. But I don't think that is enough. We are having these hearings this morning to look at four main areas, and I look forward to the testimony that we will receive.

Before we proceed, I want to ask Mr. McGrath if he has an opening statement.

Mr. MCGRATH. Thank you, Mr. Chairman.

First let me welcome our new member from Maryland, Connie Morella, for coming to share with us her travails over the W-4 form. I also welcome our new Commissioner, Larry Gibbs, members from the General Accounting Office, and former Commissioners Mort Caplin and Don Alexander.

Mr. Chairman, I am most happy to join you today in opening the first subcommittee hearing of the 100th Congress. Today's hearing on the new W-4 withholding certificate is very timely as we all know.

Tax reform was supposed to bring the public a simpler, more comprehensible tax system. But regrettably that has not happened, it has brought them a new W-4 withholding certificate which is twice as long as the other old W-4 certificate.

I realize section 1581 of the Tax Reform Act of 1986, which we all supported, required that persons file a new W-4 certificate in 1987. But I am equally as anxious to find out why the IRS decided to expand the length and complexity of the W-4 worksheet.

The public reaction to the new W-4 certificate should impress upon the IRS that it must not lose touch with the average taxpayer when it implements new tax reform legislation. I believe that it is in the mutual interest of the Congress and IRS to make tax reform work.

We worked hard enough to get the bill. Congress wants tax reform implemented smoothly, so that the public receives all the benefits that we intended.

The IRS needs to implement tax reform smoothly in order to avoid a potential institutional nightmare. The IRS may have started out on the wrong foot, but I don't believe it is too late to make sure that it finishes tax reform on the right foot.

Mr. Chairman, I am looking forward to the testimony that we are going to receive today. And I thank you for holding this timely hearing.

Chairman PICKLE. Thank you, Mr. McGrath.

Do any other Members care to make a statement?

If not, we are going to ask our first witness to proceed.

We are privileged to have this morning the Honorable Constance A. Morella, a Member of Congress from Maryland.

We are pleased to have you Congresswoman Morella. Will you please proceed?

STATEMENT OF HON. CONSTANCE A. MORELLA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND

Mrs. MORELLA. Thank you very much, Mr. Chairman, and members of the committee. I am pleased to be serving with you in the 100th Congress.

I want to congratulate you on holding the hearings which I think is so important at this particular time, and tell you that I am very appreciative of the opportunity to make some brief remarks to the committee about the travails of my constituents, and my feeling about one of the major facts that you articulated.

I would like to strongly suggest and urge that that W-4 form be revised. It should be made as simple as possible, as quickly as possible.

It is almost an understatement to say that as it stands now the W-4, with its four pages of introductions and instructions, is Byzantine in complexity and rather fearsome to behold.

Along with many of our colleagues, and I am sure all of you, I have received numerous complaints about the form from constituents who are upset—not to say shocked—at how a form which, over the years has been quite simple to complete, has become so complex and so difficult. My constituents don't understand it, and neither do I. I have tried to fill out the form, and I am sure all of you have made the attempt, too, and it is, frankly, too taxing.

I have asked to testify this morning for a very special reason. Nearly one-third of the work force in the district I represent consists of Government employees. They are people who are used to working with Government forms regularly. They understand the need for Government forms and their purposes. They also understand that sometimes these forms must be complex because they must deal with a great deal of information.

Many of my Government worker constituents, however, are baffled and upset by the new W-4. It is too complex, and needlessly so, they believe. But, they feel a special imperative to complete the W-4's, because the Federal Government is strongly encouraging them to do so, perhaps, to serve as an example for the public at large. The problem is, if Government workers, who are experienced in dealing with Government forms, find this W-4 so troublesome, imagine what it is like for the rest of us. Yet every single working person will have to face it this year.

Tax forms generally have an imposing air about them; I suppose it is the nature of that part of the Government. But, the four pages of instructions that go with this W-4 make the New York Times crossword puzzle look easy. The problem must be serious if, as I understand, the IRS has scheduled 2,000 seminars for the public to explain the W-4. A private publisher has even written a guide for it. I understand there are even VHS tapes available to explain to the public. If this isn't corrected we are likely to see special telephone hotlines, perhaps, even a Washington insider's newsletter on the W-4. And then even more formidable is this penalty clause which hits them on page 2. "You may be fined $500, if, with no reasonable basis"—and then it goes on with less tax being taken out. It is a riddle hidden in an enigma.

Mr. Chairman, without question this situation, I believe, is absurd and unnecessary. As one who has been an English teacher, I would give the W-4 form an F for clarity, and an A for obfuscation. I wrote IRS Commissioner Lawrence Gibbs early last month urging that it be simplified, and I was pleased to learn that Treasury Secretary James Baker also has called for its revision.

I am pleased that Mr. Gibbs is here. I will stay and listen to his testimony in terms of what can be done now. I do understand from what I have read that the IRS is now planning to simplify it, and I am pleased to hear that. I do hope, however, that the past will not prove to be prologue, and the cure will not turn out to be worse than the ailment.

This is not an appropriate introduction to tax simplification and tax reform.

Mr. Chairman, and members of the subcommittee, I know that you never imagined that the Tax Reform Act of 1986 would lead to this. I urge that you insure that a new and simplified version of the W-4 replace the current one as soon as possible.

Again, I thank you for the opportunity to reflect how I and my constituents feel and I could compliment you on setting up this meeting.

Chairman PICKLE. We thank you, Congresswoman Morella. You have given us very interesting testimony. We appreciate your interest in this subject.

Thank you for your testimony. Thank you very much.

Do members have any questions?

Mr. MCGRATH. I have one.

I imagine we can all give some examples of constituent complaints regarding this but, perhaps, you have one or two war stories that you would like to impart to us that impressed you the most?

Mrs. MORELLA. I could put them together in a book. And it would be kind of a joke book, except that it is real. As an example. I have somebody here who said, "In brief it represents bureaucratic criticism at its most elegant and articulate level. No one understands the form, and no one can fill it out without a lot of trouble. Yet, everyone must do it."

The suggestion is, "Please change it before it takes up 1 billion percent of our productive energy."

Someone else said, "Is the form to insure the future of H.&R. Block Accounting Service? May I suggest that the persons responsible be transferred to more complex government activities such as the ICBM or SDI programs."

Somebody said that they called the IRS and were told to call OPM, because they couldn't answer a question. Someone said they brought it to a tax accountant who took 30 minutes to fill it out. Stories go on—and my district office has also been inundated with people who have just been so troubled, some who said they were going to send it back to the IRS.

Mr. MCGRATH. I think we all have the same kind of experiences. And we look forward to hearing from Commissioner Gibbs as to what he intends to do about it.

Thank you.

Mrs. MORELLA. Again, I thank you.

Chairman PICKLE. Thank you, Mrs. Morella.

Now the committee will hear from the Commissioner of Internal Revenue Service, the Honorable Lawrence Gibbs. Mr. Gibbs has been very cooperative and we are pleased to be working with him.

We look forward to your testimony, Mr. Gibbs. I know you have already appeared before one committee this morning, at an earlier hour, and we appreciate your presence here.

Our hearing had been set for some time, and you certainly have cooperated with us in the information we have requested. So we are delighted to hear from you, Mr. Gibbs.

STATEMENT OF HON. LAWRENCE B. GIBBS, JR., COMMISSIONER OF INTERNAL REVENUE, ACCOMPANIED BY JAMES I. OWENS, DEPUTY COMMISSIONER; M. EDDIE HEIRONIMUS, ASSOCIATE COMMISSIONER FOR DATA PROCESSING; AND HANK PHILCOX, ASSISTANT COMMISSIONER FOR TAX SYSTEM REDESIGN

Mr. GIBBS. Thank you, Mr. Chairman. I do have an opening statement, which I would like to address to you, Mr. Chairman, and to the members of the subcommittee.

I am pleased to be here today to discuss some of the major issues regarding overall IRS operations. Today, I would like to cover three issues:

The Service's readiness for the 1987 filing season; the status of our computer information systems plans; and finally, the implementation of the Tax Reform Act of 1986, with some comments about the W-4 form.

These issues are clearly three of the most significant items facing IRS today. I welcome the opportunity to discuss with you what we have done and are doing to try to meet the challenges which they present.

With me today, to my right and your left is Deputy Commissioner James Owens; and to my left and your right, Eddie Heironimus, Associate Commissioner for Data Processing.

Also present today are the taxpayer ombudsman and the assistant commissioners from the various functional areas named in your letter of invitation to appear before the subcommittee today.

Since this is my first official appearance before this subcommittee as Commissioner, I would like to take a minute before beginning my testimony to restate my commitment to open and effective communications with the Congress. During recent weeks, I often have referred to the unique challenges for the Service this year is going to present, and I see them as opportunities. Indeed, a successful 1987 filing season, combined with an effective implementation of the Tax Reform Act of 1986, will significantly enhance public confidence in the Service. I am mindful that a close working relationship with the Oversight subcommittee is mutually beneficial, as we jointly address these issues and these opportunities.

As we continue to work together to make the tax administration system as good as it can be, I look forward to a continuing, productive and candid dialog with you on a number of vital issues.

Mr. Chairman, I would like to ask that my written testimony be submitted for the record at this point, and I will simply summarize the testimony for you.

Chairman PICKLE. Mr. Gibbs, your entire statement will be included in the record. I suggest, or ask, that as you proceed, if you are referring to certain parts of your testimony, tell us where you are so we can follow you more closely.

Mr. GIBBS. I will be happy to. What I will do is go through by the major categories. That way, I think, you will be able to follow along with me.

Chairman PICKLE. That will be fine.

Mr. GIBBS. First, I would like to discuss the 1987 filing season. Because we are in the earliest stages of this filing season we do not have any statistically valid data on returns filed or refunds issued

or processing time that would be useful in evaluating the 1987 filing season. Nonetheless, I would like to tell you that I am confident about this filing season. This confidence is based on both the thoroughness of planning and preparation for the filing season that we have had within the Internal Revenue Service, and on the status of our existing inventories in our service centers as we go into the current filing season.

In reviewing IRS operations, I would tell you that the principal reason that I am confident about the current filing season is that others within and without IRS have expressed confidence, based on their in-depth analyses of the efforts of the Service during the past year and a half to improve the way that we do business, particularly in the area of processing taxpayers' returns.

Two reviews were conducted in the second half of 1986. One was by an outside contractor, Electronic Data Systems Corp., or EDS, which at my request completed an updated assessment of an earlier review in 1985 of our readiness for the 1986 filing season, and then of our readiness for the current filing season.

We furnished the subcommittee with a copy of the latest EDS report. In its conclusion, EDS states that it, "Did not uncover any problems which would require immediate or short-term completion to insure a successful 1987 filing season."

Additionally, in August of last year, an in-house executive task force at the Internal Revenue Service began its review of the Service's readiness for the 1987 filing season. The IRS task force concluded that there were no serious problems or difficulties, and therefore no roadblocks to the delivery of a successful filing season.

In addition to the EDS and the IRS task force reviews of the IRS readiness for the current filing season, during the first 4 months of my tenure as Commissioner, I visited all 10 service centers and the National Computer Center in Martinsburg, WV, to meet the staff and to become familiar with the processes, and request equipment that are vital to a successful 1987 filing season.

I was impressed with what I saw, and what I saw confirms these detailed studies on the Service's readiness for the current filing season. While circumstances beyond our control may arise, we nevertheless believe that our systematic reviews of the process provide a reasonable basis for concluding that we are ready for this current filing season.

Let me run through a number of specific areas that may be of interest to you. First, our service center inventories. As you pointed out, Mr. Chairman, in your introduction, and as I am pleased to say, we have reduced our service center workload inventories dramatically, and are closely monitoring each inventory to assure that this progress is maintained and continued.

Let me give you some examples. At the end of January this year, our adjustment inventory stood at 497,000 cases, a 56-percent decline from the inventory of 1,130,000 cases a year earlier. Our unpostable inventory stood at 643,000, a 60-percent decrease from the 1,622,000 cases of a year earlier.

Because of the volume of returns that are filed and the resulting correspondence between taxpayers and the Service, we are likely to always have a large workload inventory at the service centers. The question is, can they be managed in a timely manner. Especially

now that the inventories are down, we expect to see improvement in the time that it takes for handling individual cases.

I would next like to turn to the filing season staffing, to tell you that our peak staffing during the filing season this year is estimated to reach some 39,111 employees at 10 service centers. This will be a reduction of about 1.2 percent in comparison with the peak staffing last year, which was 39,599. This decline is attributable to the reduction in our service center workload inventories, which are labor intensive. The staffing for the actual processing of returns during this filing season should remain about the same as last year.

Turning to taxpayer service, the Internal Revenue Service continues to be committed to providing prompt and accurate service to taxpayers seeking taxpayer assistance. We are also encouraging the use of automated taxpayer systems which provide callers with answers to simple tax questions and refund inquiries, and which can be used to order our tax forms. Staffing for taxpayer assistance is slightly up from last year, and we have continued to improve our training of taxpayer assisters both in terms of their technical expertise and also in terms of their communication skills.

Our forms distribution efforts are always a critical element of any filing season, and present us with many challenges this year due to the passage of the Tax Reform Act last year. We have not experienced significant delays in the distribution of tax forms this year, but we are monitoring this distribution closely.

I would like to say just a few words about electronic filing. Last year, as you may know, electronic filing was in the pilot stage for individual income tax returns, and it was a success last year.

We were able to process and issue refunds for electronically filed tax returns 2 to 3 weeks faster than refunds for paper returns, and to do so almost error free. The successful results of the pilot effort and the enthusiasm expressed by practitioners and the taxpaying public have encouraged us to expand our electronic filing to four new sites in 1987 and, therefore, this year we will have a total of seven sites for electronic filing, one in each IRS region.

For 1987 we have also introduced a new feature of electronically transferring refunds directly to taxpayers accounts at his or her financial institution. This new feature is being offered to taxpayers in the three original pilot locations.

To a large extent the success of our filing season depends on the state of our computer readiness. Before the current filing season began, the Service thoroughly reviewed all aspects of computer operations—hardware acquisition and installation, computer programs, operating procedures, computer capacity, systems acceptability testing, training and management oversight. This review indicates that in terms of computer readiness, the Service could meet the filing season's demands.

A key assessment of our computer readiness comes from what we call systems acceptability testing—testing the programs to make sure that they work and that we debug the system before we go into production. This insures that computer programs and equipment can in fact do the job correctly.

This year we at IRS finished our testing earlier than we have ever finished it before. This enabled us to have all new and revised

programs in place in all service centers before the beginning of the filing season, and that is significant.

A key to our ability to process tax data is the amount of processing time that we have available on our computers. In 1986, last year, real-time availability and utilization increased significantly over 1985, our problem year.

For example, our Austin Service Center in 1985 averaged 75 hours of real-time availability per week, and in 1986 we averaged 91 hours, a 21 percent increase. For 1987 we expect to meet or exceed last year's results.

Our National Office Command Center operates 24 hours a day in order to respond immediately to processing problems that may arise. Significant problems are reported and acted on at the national office level. While there have been a few significant problems this year, those that have been reported have been resolved in an average time of less than a day.

My current assessment, Mr. Chairman, is that the Service is ready and well prepared for the 1987 filing season. However, experience suggests caution in predicting the success of the current filing season.

I think we should recognize that the Tax Reform Act has the potential to impact adversely on the Service's capabilities at this time of the year, particularly in taxpayer service.

Finally, much of our progress can be attributed to the funding support that we have received for improving our operations. Mr. Chairman, I would like you to know that all of us at the Internal Revenue Service sincerely appreciate your personal help and the help of this subcommittee in assisting us in obtaining the funding that we need to provide the service to your constituents and our customers, the American taxpayers.

Clearly, continued support to fund taxpayer service, service center operations, and our tax reform implementation efforts is crucial to insuring a successful filing season this year. I hope you will agree that the progress that we have made in preparing for this filing season is significant, encouraging and promising.

Mr. Chairman, I will go on, unless you have some comments, to talk about our information systems and our computers—but I did not mean to cut you off a minute ago, and I think you, perhaps, had a comment.

[The statement of Mr. Gibbs follows:]

STATEMENT OF
LAWRENCE B. GIBBS
COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE WAYS AND MEANS COMMITTEE

FEBRUARY 6, 1987

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss some of the major issues regarding overall IRS operations. Today, I would like to cover three issues:

- The Service's readiness for the 1987 filing season,
- The status of our information systems plans, and
- The implementation of the Tax Reform Act of 1986 by the Service.

These issues are three of the most significant items facing IRS today and I welcome the opportunity to discuss with you what we have done and are doing to meet the challenges which they present.

With me today are Deputy Commissioner James I. Owens and Mr. M. Eddie Heironimus, Associate Commissioner (Data Processing). I have also brought with me the Taxpayer Ombudsman and the Assistant Commissioners from the functional areas named in your letter of invitation.

Since this is my first official appearance before this Subcommittee as Commissioner, I would like to take a minute before beginning my testimony to restate my commitment to open and effective communications with the Congress. During recent weeks, I often have referred to the unique challenges for the Service this year as opportunities. Indeed, a successful 1987 filing season combined with an effective implementation of the Tax Reform Act of 1986 will significantly enhance public confidence in the Service. I am mindful that a close working relationship with the Oversight Committee is mutually beneficial as we address these opportunities.

As we continue to work together to make the tax administration system as good as it can be, I look forward to a continuing, productive and candid dialogue with you on a number of vital issues.

THE 1987 FILING SEASON

Because we are into the earliest stages of the 1987 filing season, we do not have any statistically valid data on returns filed, refunds issued, or processing time that would be useful in evaluating the 1987 filing season. The numbers we do have are so preliminary that any judgment of this season or comparison with other seasons would be simply premature. Nonetheless, I am confident about this filing season. This confidence is based on the thoroughness of the planning and preparation for the filing season and on the status of our existing inventories going into the filing season.

Review of IRS Operations

Shortly after I was sworn in as Commissioner in August 1986, we established an in-house executive task force at IRS to specifically examine the Service's readiness for the 1987 filing season. Critical areas reviewed by the task force included command center readiness, service center programs, tax forms publication and distribution, reduction of service center inventories, systems acceptability testing, computer hardware installation, and taxpayer service.

The IRS task force, which was called the 1987 Filing Period Readiness Study Group and which was composed of high level field and National Office managers, concluded that there were no serious problems or deficiencies and that there should be no major disruptions to the delivery of a successful filing period.

We furnished the Committee with a copy of the report prepared by the Electronic Data Systems Corporation (EDS), an outside contractor hired to review IRS' plans and procedures for its 1987 filing season. This same contractor had also reviewed our readiness for the 1986 filing season, and their earlier report was the basis for a number of systemic changes and improvements that contributed to a successful filing season last year.

In December 1986, at my request, EDS completed an updated assessment of the Service's efforts to accomplish 43 changes previously recommended by EDS in such areas as computer operations, systems software, applications software, data communications, and workflow. In their conclusion, EDS stated that it was "pleased to report the IRS made tremendous positive changes in the period assessed and was successful in meeting the challenges identified following the 1985 filing season". EDS also stated that it "did not uncover any problems which require immediate or short-term completion to insure a successful 1987 filing season".

In addition to the EDS and IRS Task Force reviews of the Service's readiness for the 1987 filing season, during the first four months of my tenure as Commissioner, I visited all ten service centers and the National Computer Center to meet the staff and become familiar with the processes and equipment that are vital to a successful 1987 filing season. I was impressed with what I saw and what I saw confirms what these detailed studies report on Service readiness for the current filing season.

My point, Mr. Chairman, is that based on the results of two in-depth reviews of IRS readiness and my own visits to our service centers and the National Computer Center, we believe that we are well-positioned to handle whatever problems may arise. While circumstances beyond our control may arise, we believe that our systematic reviews of the "process" provide a reasonable basis for concluding that we are ready for the 1987 filing season.

Service Center Inventories

A major concern over the past two years has been the size of the service center workload inventories. I am pleased to say that we have reduced these inventories dramatically and are closely monitoring each inventory to insure that this progress is maintained. Let me give you some examples: We have reduced our adjustments inventory from approximately 1.2 million cases

at the end of 1985 to 518,000 cases at the end of 1986, a decrease of 56%. We have reduced our unpostables inventory from 1.6 million cases to 589,000 cases, a decline of 63%. At the end of January 1987, our adjustments inventory stood at 497,000 cases, a 56% decline from an inventory of 1,130,000 cases a year earlier. Our unpostable inventory stood at 661,000 cases, a 59% decrease from 1,622,000 cases a year earlier.

Although we have more than halved these inventories in one year, there is still room for further reduction. For example, seven of our ten service centers are in good shape in the unpostables area; however, three need to make continued inventory reduction efforts. Nevertheless these service centers have also made exceptional progress. For example, during this time, Atlanta reduced its unpostable inventory from 216,000 cases to 119,000, a 45% decrease; Philadelphia reduced its unpostable inventory from 181,000 to 70,000, a 61% decrease; and Brookhaven reduced its unpostable inventory from 237,000 to 74,000, a 69% decrease.

Because of the volume of returns that are filed and the resulting correspondence between taxpayers and the Service, large workload inventories at the service centers are not unusual. The question is: Can they be managed in a timely manner? Especially now that inventories are down, we expect to see improvement in the time it takes to handle individual cases. As part of our ongoing effort to address this issue, the National Office and the service centers are jointly monitoring these inventory levels on a weekly basis, taking continuous actions to reduce these inventories, and advising me of the results of these efforts.

Filing Season Staffing

Peak staffing during the filing season is estimated to reach 39,111 at the 10 service centers for 1987. This is a reduction of 1.2% in comparison with the 1986 peak staffing of 39,599. This decline is attributable to the reduction of service center workload inventories which are labor intensive. Staffing for actual processing of tax returns during the filing season should be about the same as last year. Because we do not foresee any unmanageable processing problems, we believe our current returns processing staffing is adequate to the task.

Taxpayer Service

Before the 1987 filing season began, the Service set several objectives for the Taxpayer Service program. Two major objectives were continuing to provide prompt and accurate service to taxpayers seeking telephone assistance; and encouraging the use of automated telephone systems which provide callers with answers to simple tax questions and refund inquiries and which can be used to order tax forms.

A staff of 3,500 assistors is expected to handle 16 million calls during the filing period on 3,500 toll-free phone lines. By comparison, during the 1986 filing season, we had 3,400 assistors on 3,400 phone lines, who handled 19.1 million calls. This projected decline of three million calls can be attributed primarily to an increased use of the automated telephone services I just mentioned.

You will note that we have more personnel handling fewer calls from taxpayers. Let me explain why this is. The manner in which Taxpayer Service conducts business has changed in recent years. We are employing a variety of new technologies to automate our assistance. Collectively, these initiatives have resulted in a shift in the taxpayer service workload away from a preponderance of non-technical, routine inquiries to a mix which includes a substantial percentage of more complex tax law and account-related inquiries. In addition, Taxpayer Service is emphasizing improved communications techniques together with one-stop assistance--providing full service the first time a taxpayer calls--in an effort to provide the highest quality assistance to the public. Call lengths are increasing, which means we assist fewer taxpayers each hour. As a result, a larger number of assistors are needed to answer a smaller volume of calls this year.

We are continuing to stress quality and training for Taxpayer Service staff. Training courses have been revised to improve telephone assistors' tax skills and communication abilities. Our quality review staff will also be making calls to toll-free sites to assess the quality of telephone service and supervisors will monitor calls at the sites as a regular part of their management responsibilities. Further, all Taxpayer Service Specialists have been trained on the new Tax Reform Act of 1986, and all Taxpayer Service assistors have been given an overview of the Act.

Forms Distributions

Distribution of forms is always a critical element of any filing season and always presents us with challenges. Those challenges are heightened this year due to the Tax Reform Act of 1986. Although we have not experienced significant delays in the distribution of tax forms this year, there are some that we are monitoring closely.

The Tax Reform Act of 1986 had little effect on 1986 tax forms and instructions for individuals which were delivered on schedule. The printing and distribution of some 1986 business and partnership tax forms were delayed because of the late enactment of the Tax Reform Act of 1986, with the accompanying changes in the corporate and partnership areas that especially affected fiscal year taxpayers. However, sufficient quantities of the necessary forms and instructions are being issued in time for partnerships and businesses to file their returns.

Last year we piloted a toll-free telephone system specifically for ordering tax forms. This system is now in operation in two sites: Richmond and Bloomington. Our data indicates that recently the Richmond site has been experiencing an overload of phone calls ordering forms. We are reviewing the situation to determine if there can be some redistribution of the forms ordering workload to take the pressure off the Richmond site. I should point out that this system overall appears to be working fairly well in terms of providing service on the first call and back ordering out-of-supply forms. Subsequent data will give us a clearer picture of how well the system performs.

Electronic Filing

Last year for the first time taxpayers were able to file their returns with the Service electronically rather than file in paper form. The Electronic Filing Pilot for individual income tax returns was a success. We were able to process and issue refunds for electronically-filed tax returns two to three weeks faster than refunds for paper returns. At the same time, the error rate for electronically filed returns was only 3% while the error rate for the paper similar returns was 20%. Although the significance of these results is tempered by the relatively low volume of 25,000 returns, the successful results of the pilot effort and the enthusiasm expressed by tax return preparers and the taxpaying public have encouraged us to expand electronic filing to other sites in 1987.

The number of forms and schedules that may be filed electronically with Form 1040 refund returns has increased this year. As a result, in 1987 about 70% of the individual taxpayers due refunds in the covered geographical areas could file their returns electronically if they wish to do so. We also are expanding the number of filing sites. In addition to the original sites of Cincinnati, Raleigh-Durham-Fayetteville, and Phoenix, the Service is accepting electronically filed returns from the Sacramento, Milwaukee, Albany-Schnectady-Troy, and Norfolk, Virginia Beach-Newport News areas. These additional locations provide one site in each of the Service's seven regions and continue the pattern of testing within medium-sized metropolitan areas. In 1988, we will begin phasing in what will become a fully operational electronic filing system.

For 1987, we have also introduced a new feature of electronically transferring refunds directly into the taxpayer's account at his or her financial institution. This new feature is being offered to taxpayers in the three original pilot locations.

Computer Readiness

To a large extent the success of our filing season depends on the state of our computer readiness. Before the current filing season began, the Service had thoroughly reviewed all aspects of our computer services--hardware acquisition and installation, computer programs, operating procedures, computer capacity, systems acceptability testing, training and management oversight. This review indicated that in terms of computer readiness the Service would meet the filing season's demands. Let me point out some of the specifics of the review of our computer readiness.

Comprehensive operations readiness questionnaires were sent to all regions and service centers in November 1986. The results identified no significant filing season concerns in terms of computer operations, support, and management controls.

Hardware readiness reviews were conducted at each service center during the last quarter of 1986. These reviews focused on the Sperry 1100 computer systems, front-end communication processors, laser printers, communication terminals, the remittance processing equipment, the non-impact printing systems, and the Distributed Input Systems. At each site a representative of the UNISYS Corporation was also present to assist in reviewing of all Sperry equipment and support functions. The reviews concluded in early December 1986 and identified no equipment or support function problems identified.

Another key assessment of our computer readiness comes from what we call our systems acceptability testing. This insures that the computer programs and equipment that process tax returns can, in fact, do the job correctly. Testing the procedures to make sure that they work debugs the system before we go into production. Due to the quality and timely preparation of our program changes and associated documentation, IRS finished its testing earlier than ever before. This enabled us to have all new and revised programs in place in all service centers before the beginning of the filing season.

A key to our ability to process tax data is realtime availability which indicates the amount of processing time we have available on our computers. In 1986, realtime availability increased by 23% over 1985. Also, utilization of scheduled realtime increased from 93% in 1985 to 97.4% in 1986. Our Austin Service Center in 1985 averaged 75 hours of realtime availability per week and in 1986 it averaged 91 hours, a 21% increase. Austin utilized 93% of its available realtime in 1985 and 98% in 1986. For the 1987 filing period, we expect to meet or exceed the 1986 results.

A National Office check on readiness is our National Office Command Center which operates 24 hours a day in order to respond immediately to processing problems that might arise. Significant problems are also reported quickly to upper management at the National Office. While there have been a few significant problems, those that have been reported have been resolved in an average of less than one day.

Furthermore, during the week of January 19, 1987, the National Office began conducting two sets of filing season telephone calls. The first set of calls are the "Weekly Significant Events Calls," which involve calls from the two National Office assistant commissioners in charge of returns processing and computer systems to the appropriate assistant regional commissioners to obtain information on significant filing season items. We are also conducting "Biweekly Operational Calls" which are intended to be an information sharing session between the field and National Office officials to address anticipated changes and problems.

Additionally, we have continued an extensive training program for all new computer operators and schedulers. We have reassessed the Computer Services Division staffing levels to provide the service centers with more flexibility in utilizing resources according to their unique workload requirements. I have been assured that the computer rooms in our service centers are adequately staffed with well-trained personnel. Risk analyses have been performed at the majority of our service centers, and we are in the process of completing them at the remaining centers. We also have conducted reviews to ensure that appropriate data integrity safeguards are in place.

These assessments and key indicators of computer readiness all point to a high degree of preparation for the filing season.

Current Assessment

To summarize, Mr. Chairman, my current assessment is that the Service is ready and well-prepared for the 1987 filing season. Our service center workload inventories are down substantially from a year ago. Forms have been printed and distributed despite the challenge of incorporating the latest Tax Reform Act changes. Computer equipment and software have

been put in place and tested to assure adequate capacity and back-up for this year. Taxpayer service staffing has increased and is trained to give well-informed and more responsive answers. Initiatives such as Electronic Filing which will ultimately reduce our paper processing workload are expanding.

Our Taxpayer Service and Problems Resolution staff indicate that thus far no significant filing problems have arisen.

Experience suggests caution in predicting the success of the current filing season. We should recognize that the Tax Reform Act has the potential to impact adversely on the Service's capabilities during this time, particularly on Taxpayer Service. Finally, much of our progress can be attributed to the funding support we have received to improve our operations, and we sincerely appreciate your help in this regard. Clearly, continued support to fund our taxpayer service, service center operations and tax reform implementation efforts is crucial to ensure a successful filing season. However, I hope you will agree that the progress we have made in preparing for this filing season is significant, encouraging and promising.

INFORMATION SYSTEMS

At this point, I would like to spend a few minutes discussing how the Service plans to make full use of its information systems to provide taxpayers better service for every dollar spent on tax administration.

Description

Any discussion of IRS information systems must begin with some definition or explanation of what is encompassed by that term. This is more important than it might seem at first glance because the Internal Revenue Service of the late 1980's is more and more dependent on automated systems to accomplish its mission efficiently. This trend will can only increase into the 1990's as the volumes of work we deal with continue to grow.

In this context, we define "information systems" broadly, to include computer and telecommunication systems. The term certainly includes our ten service centers, the National Computer Center, the Computer Services organization, the Detroit Data Center, and the Tax System Redesign initiative---but it is much more. The electronic filing system I mentioned earlier is an information system, as is our multi-functional telephone answering equipment in Taxpayer Service, and our automated system of ordering and distributing tax forms.

Information systems are a large and growing part of our compliance activities too. The Automated Collection System (ACS) is perhaps the best-known example here, but there are a number of others in operation or planned. For example, the Information Returns Program, also known as the document matching program, is computer driven and a major revenue producing program. Both Chief Counsel and Appeals have automated tracking systems for case management and research. In the fall of 1988, we will pilot, in the Southwest Region, the Integrated Collection System in an attempt to link the Collection data bases. The Automated Examination System (AES), which will eventually automate almost all audit activities, began its initial implementation in the spring of 1986. There

are additional computer operations, such as office automation, various budget and planning systems, in almost all Service areas, but I think the point is clear: IRS is in the computer age in a big way.

We are acutely aware that the computer systems we have in place now for processing tax information will not meet the demands of tax administration in the 1990's and beyond. The current computer systems used by the Service for the processing tax information were developed in the early 1960's. In addition to realtime capacity problems, the outdated design of the current computer systems places significant constraints on the ability of that system to best serve taxpayers. Very simply, the Service must take advantage of new technologies in order to maintain and improve its ability to process returns, make refunds timely, and maintain taxpayer accounts accurately in the face of an increasing tax administration workload. As a result, the Service has been concentrating on the redesign and integration of its computerized information systems under the auspices of what we call Tax System Redesign (TSR).

Tax System Redesign

The key design concept behind TSR calls for an information system that will provide rapid access to tax information, as opposed to the present system which is based upon an information data base maintained on thousands of magnetic tapes segmented in various Master Files such as our Individual Master File and Business Master File. Processing and using tax information as it is currently stored for compliance activities such as examination and collection is a relatively slow process and it is difficult to bring all of the information we have together in an efficient manner.

The central element of this new system is a Corporate Data Base that will encompass all the commonly used information for tax administration throughout the Service. Information contained in the data base will include taxpayer account information, information returns files, paper document images, comprehensive management information and reference information. This information will be available through a nationwide telecommunications network.

Service functions such as taxpayer service, examination, collection, criminal investigation and returns processing each have specialized information needs. This information will be available in what we call Departmental Data Bases which will provide rapid access to information needed by field personnel to maximize their efficiency in performing their duties. This Departmental information will be fully integrated with Corporate information as opposed to having the independent systems we have now. The automated projects I just reviewed for you serve as the foundation for the Departmental Data Bases in the TSR plan.

As you can see, the design of the system is well underway. In fact, we expect to have a comprehensive management plan developed by the spring of next year which will lay out in detail the actions necessary to fully implement the redesigned system I have just described.

I have gone into some detail about TSR because I believe that it is important that you understand this redesign concept. I am sure that we will have many more discussions about our redesign of the tax administration system and I welcome your input. What I hope I have communicated to you

today is that the Service is moving ahead towards the future with careful planning and a clear understanding of what will be needed to meet the demands of administering the tax laws in the 1990's and beyond.

Interim Computer Capacity

In the meantime, the Service has not been complacent about the interim period between this filing season and the mid-1990's when TSR should be fully operational. A task force within the Service has been created to identify specific actions to insure adequate realtime capacity into the mid-1990's. This task force is looking for methods to extend computer capacity further and has already identified a number of initiatives that will give us more capacity. We believe that with these recommendations, along with others to be identified by the task force, we will have adequate capacity until such time as TSR is in place.

Summary

The amount of information that we handle every year is staggering and yet, overall, I think that the Service does its job in an excellent manner. I firmly believe that the Service is up to the challenges that we face. As I have already said, we are in very good position for this filing season. Our plans with TSR give us reason to be optimistic in the long run. However, we certainly need to give much consideration to the interim period between now and when TSR comes of age.

TAX REFORM IMPLEMENTATION

Let me now turn to our most significant short-term challenge -- implementation of tax reform. I believe this is one of the most exciting periods in the history of tax administration as we work to implement the most significant piece of tax legislation enacted in the last 30 years. Successful IRS implementation of tax reform is one of my top priorities.

Implementation

The planning for implementation began long before I arrived last summer. Throughout the 30 months of development and Congressional consideration of the tax reform legislation, IRS tracked each proposal to assess its potential impact on our current systems and on taxpayers.

As the final outlines of tax reform became clearer, the IRS began its implementation process even prior to enactment of the Conference Report. For example, a decision was made last summer to run dual computer programming efforts -- one track developed software changes under the old law and another in contemplation of the changes that would go into effect on January 1, 1987 under the proposed new law. This was a responsible decision to properly prepare for the alternatives. As a result, our automated programs were ready, tested and in effect in January 1987.

In addition, before the Act was passed, we prepared a detailed plan to implement the new tax law provisions. This plan, for example, includes a list of every action accomplished by Mid-January 1987. This plan was developed in order to revise the forms, change the automated programs, issue technical guidance and change procedures that had to be in place by January of this year.

We are now concentrating on a plan which identifies every adtion that must be accomplished and the target dates by which each action must be completed over the next several years in order to implement the entire new Act. The Committee was provided with an excerpt from this plan to illustrate the complexity and detail of actual implementation. Please understand that a large organization is multidimensional -- one process depends upon the timely completion of another. For example, in order to submit a request for a data processing change, the elements of a particular form must be established. The form, in turn, may depend on resolution of an issue in the regulations. Since the new tax reform legislation may ultimately affect over 500 of our forms, dozens of our automated programs, and will ultimately require thousands of changes to our internal procedures, you can see that careful and precise planning is an absolute necessity. Fortunately, we've had a great deal of experience in implementing new systems and new legislation. But to keep me advised of the process, I have put into effect several new mechanisms to plan and monitor the progress of tax reform implementation.

Control Group

To oversee implementation, I have established a control group of selected IRS officials. Their role is to advise me on the progress of planning for implementation, and bring to my attention those issues requiring policy decisions on controversial issues or programs affecting multifunctional operations.

The control group also organized a series of public meetings to provide information on several areas in the tax reform legislation that are of interest to particular groups. One of these public sessions focused on provisions that are of interest to employers and employees such as how to help employees fill out their Forms W-4, the new rules on employee business expenses, and the new rules for IRAs.

Milestones

Another initiative which is underway is the development of pre-identified milestones that will assure me that we are implementing each action timely and that I will receive early warning of problems. I am determined that we be as ready for the 1988 filing season as we are for the current filing season.

Regulations and Guidance

One of the most troublesome areas in the past has been the timely issuance of regulations. This year, to expedite development of critical regulations, we worked with Treasury to designate responsible executives for pre-clearance of controversial policy issues.

In October, shortly after the President signed the tax reform bill, the IRS issued a press release stating our priorities in providing guidance on 76 sections of the new Act. This press release also asked for comments on these priorities and suggestions on other areas needing early guidance.

As of January 26, 1987, we had issued guidance in almost 40 percent of the priority areas. Guidance in many of the rest of the priority areas will be published during the next few months. As of January 26, 12 Announcements, 23 Notices, 10 Revenue Rulings, and 3 regulations had been issued under the new Act. These items covered a wide variety of topics.

The process mentioned earlier for setting and establishing critical milestones also includes publication of regulations and other guidance. I want to be sure that processes that are critical to the 1988 filing season are not delayed because we haven't published a regulation resolving a critical policy or technical issue.

Education Efforts

Early implementation efforts concentrated on providing technical guidance to our employees and to taxpayers. We have started a program which will provide every IRS manager and employee with appropriate training in the new law. We have also taken a new approach in issuing guidance. The traditional approach of relying on comprehensive regulations takes too long. Instead essential issues are being addressed first and less important issues will be addressed later. A variety of vehicles are used to publish guidance: temporary and proposed regulations, Internal Revenue Bulletin announcement, revenue procedures, rulings, forms instructions and special publications. Also, a variety of media are being used to publicize this new information including televised press conferences, speeches, fact sheets, and news releases.

Our National Office and field executives and our taxpayer assistance offices are also implementing an ambitious outreach program to inform taxpayers of new programs. A 20 minute "How To" video tape on preparing the the Form W-4 is available to all employers and in more than 7,000 libraries around the country. Several major commercial video tape distributers are duplicating the tape and placing it in rental video outlets. Public service announcements on the new tax law have been provided to 800 television and 7,000 radio stations nationwide. Another video covering the Form W-4, social security numbers for dependents, the new IRA rules and other changes pertinent to 1987 has been provided to more than 500 TV stations nationwide. The products of many other initiatives are now available including tax clinics for public television, audio tapes, tax briefs for use by commercial stations, and scheduled C-Span programs featuring IRS tax experts who are available to answer questions phoned in by viewers.

Other outreach efforts are focusing on providing tax experts versed in the new law to groups of practitioners, employers, community groups and others. Other efforts have focused on the print media to offer camera ready clipsheets for separate articles or series on tax reform.

Assessment

Overall, I am optimistic that we can provide adequate and timely guidance to taxpayers and that we can, through careful planning and monitoring, implement the systems and procedural changes needed to successfully implement the new Act.

CONCLUSION

Mr. Chairman, I have covered a lot of ground this morning. I would be glad to answer any questions that you or other members of the Committee might have.

ADJUSTMENT INVENTORY: 1986 vs 1987

	1-31-86 Inventory	1-30-87 Inventory	Differ.	Percent
ANSC	68,511	56,188	(12,323)	-18.0%
ATSC	147,874	72,130	(75,744)	-51.2%
AUSC	176,718	45,890	(130,828)	-74.0%
BSC	110,734	68,022	(42,712)	-38.6%
CSC	26,656	31,558	4,902	18.4%
FSC	183,788	53,451	(130,337)	-70.9%
KCSC	47,540	34,744	(12,796)	-26.9%
MSC	69,344	39,396	(29,948)	-43.2%
OSC	77,046	38,125	(38,921)	-50.5%
PSC	221,845	57,451	(164,394)	-74.1%
TOTAL	1,130,056	496,955	(633,101)	-56.0%

Unpostable Inventory: 1986 vs 1987

	1/31/86 Inventory	1/30/87 Inventory	Difference	Percent
ANSC	100,321	49,978	(50,343)	-50.2%
ATSC	216,480	119,381	(97,099)	-44.9%
AUSC	253,160	60,252	(192,908)	-76.2%
BSC	236,565	74,228	(162,337)	-68.6%
CSC	84,084	40,052	(44,032)	-52.4%
FSC	274,715	87,488	(187,227)	-68.2%
KCSC	73,367	77,448	4,121	5.6%
MSC	126,619	50,766	(75,853)	-59.9%
OSC	76,609	31,310	(45,299)	-59.1%
PSC	180,532	70,218	(110,314)	-61.1%
TOTAL	1,622,452	661,121	(961,331)	-59.3%

Chairman PICKLE. Commissioner, I had assumed you had a lot more testimony but since we have put it all in the record, we will proceed with questioning on a different subject.

Let me ask you to run by for me again and for the committee information how you are handling the W-4 form.

Let me say to the committee I think we will proceed this morning on the basis that we have four items basically for coverage. We will start with the W-4 form. I want the committee to be able to proceed and ask any questions they want to on the W-4 form.

Mr. GIBBS. Could I make an introductory statement?

Chairman PICKLE. Then after finishing the W-4 questions we will come back to the 1987 filing season and to the computer operation, taxpayer service, and that type of thing.

First, why don't we take up the W-4. You made some reference to the W-4, but it was a mighty quick reference, and I want you to go into that a little bit more for me if you will.

Mr. GIBBS. Certainly, Mr. Chairman. The Tax Reform Act, as we all know, was enacted in October of last year, and made several changes to withholding. First, it required that every employee file a new W-4 form by October 1 of this year, 1987. Second, the new act directed the Internal Revenue Service to make withholding more accurate. Third, it required that this new W-4 form be developed and distributed by the Internal Revenue Service with the two foregoing matters in mind on a timely basis.

As you know, in our tax system there is a constant tension between fairness and simplicity. In the world of withholding, this translates into a tension between accuracy and simplicity.

In developing the tax reform legislation, Congress and the Internal Revenue Service realized that tax reform presented a unique opportunity to introduce more accuracy into our withholding system. Indeed, for the first time in our history, we have the capacity for withholding to now match the brackets for income tax liability.

While not perfect in each and every case, our new form W-4 was redesigned to obtain the most accurate answer for the largest possible number of taxpayers among the over 100 million individual taxpayers in this country. At the same time it allowed most taxpayers to complete only a small part of the form, the first five lines, as most of them have done in the past.

It is now clear that our efforts toward accuracy have produced a form which has caused concern for a significant number of individuals. Very simply, the length of the form, its language and the number of computations have worked against our efforts to assist taxpayers in the early adjustment of their withholding for the effects of tax reform.

If this is the result, then our efforts towards accuracy are obviously less productive and, in the larger picture, we risk having the public's perception of tax reform negatively impacted. So where do we go from here?

Mr. Chairman, we have heard your concerns, as well as those of others in Congress on this issue. We have also heard Secretary Baker's concerns, as well as those of taxpayers themselves, many of whom have written or spoken to me personally about the W-4 form.

I share the belief of many that if the current W-4 form is not working as intended for many American taxpayers, then the Service should respond to that, hopefully with a simplified form.

For that reason I have sent our technicians back to the drawing board on the instructions and the related materials accompanying the W-4 form. We do not expect the form itself—the small, one-third page size sheet that is given to employers by employees—to change, because that is not what is causing the problems. We are working on ways to simplify the instruction and the worksheet information, while maintaining sufficient levels of accuracy regarding tax liability.

As you know from last year's tax reform effort, additional simplicity often involves a tradeoff for accuracy. A simplified form will require certain broad assumptions and will consequently lead to less precise calculations. Currently we are reviewing the alternatives in this area to try to determine how much simplicity can be obtained with adequate levels of accuracy.

Although I am not in a position to make any announcement this morning, I want you to know that we at the Internal Revenue Service, and I personally, have been working on this virtually continuously over the last several weeks—during the day, in the evenings and on the weekend. We are committed to completing the review of the alternatives and to doing something about the problems that we face as soon as possible, hopefully in the next several weeks.

In this effort, Mr. Chairman, I pledge to make every effort to include you and your subcommittee in the process, if you wish. I will also tell you that it is our goal to address the problems that the new form is causing to your constituents and our customers, the American taxpaying public.

I will be glad to answer questions.

Chairman PICKLE. Commissioner, I appreciate your statement and your intent. It seems that you have had severe complaints from the public as well as from Senator Bentsen and Secretary Baker, and now Mr. Pryor has joined in on the outcry. You held a press conference last November in which you announced with great gusto that you had a W-4 form now for the first time that was personalized and will match income against the deductions and the credits. In reading that press release, it indicated that you felt very strongly that you had a good form.

Since that time it has encountered a literal hailstorm of protest. I understand that 10 percent of your phone calls coming into your taxpayer service outlets, 10 percent of them are in complaint of the W-4. If that is so, or whatever percent it is, obviously it is a difficult matter.

I think you have to decide, is your W-4 appropriate or should you get a new one, and now you have indicated that you are going to go back to study it, but you said you hoped you might do that in the next few weeks.

Let me just back up a little bit. I think you have got a problem, as I see it. If your W-4 form is a good one and really does what the Congress says, then you ought to stick with it and not be just blown away by criticism if you think it is really what ought to be done.

It would seem to me that we in Congress have a question we have to ask ourselves too. We mandated a new W-4 form by the change in the tax laws because we raised the exemptions, we had to take into account spousal income and outside income, and we made other changes requiring that you do it, so you come up with a different form.

We mandated also that withholding had to be 90 percent accurate, or the taxpayer would suffer a penalty. So I would ask you, did the Congress go too far? Were we too strong in requiring a 90 percent compliance, that is, a compliance and achievement of accuracy?

Mr. GIBBS. Mr. Chairman, one of the things we are finding as we look at the form that is out there and consider the alternatives is that there is a very, very difficult tension that I mentioned a minute ago, between the accuracy that is embodied in that form and simplicity. For all of its faults, it is an accurate form in terms of coming up with the proper amount of withholding liability; but what we are finding is that, notwithstanding that accuracy, there is obviously a point at which the accuracy becomes irrelevant if the form is too complex for taxpayers to deal with.

Now, what we are trying to do is to come up with a simpler form, but one that will not result in substantial and unacceptable over- and under-withholding.

Chairman PICKLE. But if you wait now for a considerable length of time to come up with a new form—are you announcing you are going to come up with a new form, is that what you are saying to begin with?

Mr. GIBBS. No, sir. I am saying that we are trying to see whether we can. I would very much like to find some way——

Chairman PICKLE. It would seem to me that the Internal Revenue Service can be more definite in what you are going to do. It shouldn't be that complicated. Either you are going to have a simpler form or you are not. If you are going to make it simpler, what would you knock out in the form that you are listing now?

Mr. GIBBS. We are now developing a form which we have gone out to talk to taxpayers and others about; they can read it and they understand it.

Chairman PICKLE. I don't think the average taxpayer can read it and understand it. I think some of the accountants and C.P.A.'s——

Mr. GIBBS. No, sir. I mean the new one. We are actually developing a form which we are beginning to test.

Chairman PICKLE. You hope the taxpayers will understand.

Mr. GIBBS. That is correct. We are asking people, "Can you understand it? Can you follow it?" We find the answer to that is "Yes." But what we are also finding, Mr. Chairman, is that in our desire for simplicity, we have to be very careful. We are now computer testing that form and we are finding that there are some problems with under- and over-withholding, because in our desire to make it simple, it is less accurate. The one thing we don't want to do is to come out with a form that, although simple and understandable, creates another problem that is equally unacceptable.

Chairman PICKLE. I am sympathetic to that, but this is February 6. Three months ago you announced with great pride you had the

new W-4 form that Congress intended. We did mandate a new form. We did mandate that you be accurate. We almost required the W-4 to be the tax return itself. And it is almost that strong, if we follow the procedure that you said the Congress intended.

I think you have to ask, did Congress intend that, and we should answer that. But I am saying to you that if you are going to make it simpler, and you have indicated you are going to, when are you going to do it and why does it take several weeks? You have had 3 months now to worry about this and apparently you haven't come up with an answer, and even now you say it is going to take several weeks more.

Now it is mandated by October 1 anyway. Most people wait until the last minute to file their returns. They just do it, so the longer you wait, that means there are going to be more errors in either under-withholding or over-withholding, and that means in effect, it seems to me, that inevitably taxpayers are going to end up this next year owing more money than they did before. Always before we had refunds. Now they are going to owe more money, the more delay you have. So I just simply say to you if you are going to have it simplified, then do it, and do it immediately, and not wait until Easter or some such time.

It seems to me like the American people ought to know, and that is what I urge you most of all. If you are going to defend what you have here, then you ought to say so. If not, and you are going to accede to the cries of whoever has been protesting, and I can understand because it is complicated, then I say do it quickly, that is the main thing.

Mr. MCGRATH. Will the Chairman yield on that?

Chairman PICKLE. I recognize you, Mr. McGrath.

Mr. MCGRATH. Just to follow up, I have here the language of Subtitle H, Miscellaneous Provisions on the withholding allowance to reflect the new rate schedules. Subsection (1) states, "In general, the Secretary of the Treasury or his delegate shall modify the withholding schedules and withholding exemption certificates under section 3402 of the Internal Revenue Code. . . ."

Then subsection (b) deals with certain decreases in withholding not permitted. Subsection (c) then goes into employer responsibilities, and basically what it says, if an employee has not filed by October 1, 1987, the employer shall withhold income taxes from the employee's wages, one, as if the employee claimed one withholding allowance if he were single, and, two, if he were married, to claim two.

Now, that is the entire section of the law. How did we get a W-4 form with four pages of instructions out of a section of the law that has less than three paragraphs?

Mr. GIBBS. In passing the Tax Reform Act, the Internal Revenue Service was instructed to provide a new W-4 form and to make that new W-4 form more accurate, as I indicated.

Mr. MCGRATH. How accurate is the present W-4 form?

Mr. GIBBS. By present do you mean the old one or the one we have out there?

Mr. MCGRATH. The old one.

Mr. GIBBS. The 1986?

Mr. MCGRATH. That is correct.

Mr. GIBBS. In our opinion it is nct as accurate as the one that we have out at the present time.

Mr. MCGRATH. Give me the difference between the accuracy of the new one and the accuracy of the old one.

Mr. GIBBS. Let me approach that question this way. One of the principal problems I think we have here in looking at the situation is this: For many years in this country, notwithstanding the tax legislation that we have had, most individual American taxpayers, particularly your low- and middle-income taxpayers, really have not been impacted substantially by that legislation. They have not had to worry with the W-4. They may have filed it when they originally went to work, perhaps when they changed jobs, maybe when they bought a new home or something like that, but very infrequently. They haven't looked at it. They haven't dealt with it.

What they have done over a period of years is to find how to address their withholding to meet whatever their tax liability and desires are with respect to refunds. When the law changed last year, it took 15 rates and made them into five brackets and then to two. We told the American public that this was a substantial change, that it was going to impact everyone, and indeed it does. The law also increased the personal exemption from $1,080 to $1,900 this year and $2,000 next year, which almost doubles it.

Those are the two things that you need to work with to construct a W-4. What taxpayers are finding is that they don't know what their tax liability is going to be for 1987, and when they get through with the W-4, they really don't know what that W-4 has done because all they have done is filled in a number of exemptions. I really think that part of the problem here, when we start comparing the old form and new form is that it is so totally different for most taxpayers in terms of coping with whatever complexity or whatever inaccuracy there may have been in the past in comparison to this year, Congressman.

Mr. MCGRATH. It seems to me, Commissioner, that the average American taxpayer, if he were single, would check one and have one withholding allowance. The average married would have two. If he had three or four children, he would take as many as the number of children he may have. If he is like me, he takes nine, so he has enough money to be able to afford to live in Washington.

But my point is that nowhere in the section of the law have we, in my judgment, prescribed that a W-4 form totally different than the one that was in use in 1986 and prior be instituted. I wonder why frankly and who designed this thing.

In any event, since you are going to adjust it in one way or another, what kind of advice do you have for taxpayers who have not filed their W-4 form and don't have to file until October? Do you think that they should try to file the one that is in existence today, or wait until a new one comes along? What kind of advice do we have for our taxpayers?

Mr. GIBBS. Congressman, I would like to follow up on the comment that the chairman mentioned, and say that we are cognizant of this dilemma. You have taxpayers out there who in the early part of this year suddenly found that they had an increase in take-home pay because they left their old W-4 in existence, and when the employer applied the new tables against the old form, it meant

less withholding and more take-home pay. Those folks may be in a situation where they are facing good news this year and potentially bad news next year. That is to say, they may have a tax liability next year that they don't anticipate this year.

Therefore, I would say to those people that during this period of time, until we can get something out that addresses this issue, I would urge them either to deal with the long form and complete it as best they can. If they are unwilling or unable to do that, then I would at least encourage them to file a new W-4 form and increase their withholding back to what they were withholding last year, so that they won't be under-withheld this year. That is the advice that I can give at this point.

Mr. McGRATH. If that is the case, then are you going to waive the penalty?

Mr. GIBBS. The Congress really has, I think, given me a cue, and it is this. In 1984 and in 1986 when the Congress passed major legislation that made it difficult because of the timing of the legislation for people to estimate withholding properly, they waived the withholding penalties, the estimated tax penalties.

We have a form out there that is creating problems, and for that reason I would simply say this. If anyone uses that form, fills it out timely and properly, and—although we don't anticipate this—if by any chance in filling out that form they are subjected to a penalty under the 90 percent provisions, then we most certainly would waive that.

In the near future, we will issue an actual statement that will provide guidelines with respect to when we will waive the penalties. The thrust of it will simply be that if you have tried to comply with your withholding obligations, made a sincere effort, and are unable to do so because of the problems of the form, then we will find a way to waive those penalties.

Mr. McGRATH. Thank you. I have further questions later on, and I yield back the balance of my time at this particular point in time.

Mr. FLIPPO. Thank you, Mr. Chairman.

Let me ask you, if Congress had not increased the necessity of paying estimated taxes to 90 percent, and changed the withholding, would you have to make the changes in the W-4?

Mr. GIBBS. Congressman, I believe we would. Again, I think the key here is not so much the increase in the safe harbor, but really the way in which Congress reduced the number of tax brackets from 15 to 5, as well as the gaps between those brackets. By that I mean, between the 15 percent and the 28 percent bracket, there is a gap of some 13 percent. The way we measure withholding is through exemptions that are now worth $2,000 instead of $1,080. So I think that you will find, and I think what really motivated Congress in asking us to change the form, was the difference in the rate structure, the exemptions, and the reduction in the withholding allowances. So I think we would still have to put out a new form.

Chairman PICKLE. The committee will resume its sitting. We will proceed.

Mr. Flippo was inquiring of the Commissioner.

Mr. FLIPPO. Mr. Commissioner, the point I was trying to make is that I think the W-4 is a good example of the problems that we are

facing with our voluntary tax system. It does give the impression to the person trying to fill out the form that it is not fair. The form is too complex and unreasonable in the information that is being asked for.

If he is unable to understand it and to file it in a timely basis, the Congress has increased the penalties for his nonaction to a significant degree.

It seems to me it looks like a big axe over the head of the taxpayer when he is given a very complex form to fill out and then the penalties have been increased dramatically by the Congress.

That has a tremendous impact on his concept of fairness. If your agency has to start digging out tax information, you are going to be in serious trouble, aren't you?

In other words, things that impinge upon the cooperation of the taxpayer and reduce his confidence in the fairness of the system increases your difficulties tremendously, doesn't it?

Mr. GIBBS. Congressman, it does. That is why I am trying to say, as well as I can say it at this point, that I am concerned about the problems we are having with the new W-4 form.

I sympathize with the inability of folks to cope with it. We are going to try to do something to address that. I think it is important for your constituents and my customers to believe they have an agency that is trying to do the right thing.

Mr. FLIPPO. I recognize, and members of this panel certainly recognize, that you need to collect revenue and that your role is to enforce the tax law. It is also important, since you are the main party communicating with the taxpayer, that he have the feeling of fairness, because if we lose that, we are not going to collect revenues, no matter what you do.

Mr. GIBBS. I agree.

Mr. FLIPPO. I appreciated very much your statement that you intended to have open and effective communication with the Congress.

I know you are trying to have open and effective communication with the taxpayer which is just or maybe more important than the first one.

Let me ask you if you are proceeding on backup systems for all your computer operations in the event you have computer failures like you have had in the past?

Mr. GIBBS. Yes, yes we are. One of the things I know has been of concern in the past to this subcommittee was whether with respect to our front-end processors, will we have backups for those.

The answer is, yes, we do. We will. As we begin to test the new ones, we are going to keep the old ones in place until we know the new ones work.

Mr. FLIPPO. Let me just make a request of you. Communication is a two-way street. It is listening and talking, as well. Let me request that you be as forthcoming in helping us better understand the actions that we take that may make the process more complex from an administrative point of view.

In other words, that effective communication, what you are hearing from that taxpayer out there. When we are looking at policies in regard to tax law, I hope you will be very forthcoming and candid with us in telling us how we can do that in a way that is

best administratively and the impact on the fairness to the taxpayer, as well.

Thank you very much for your statement.

Mr. GIBBS. Congressman, thank you.

I will certainly try to do that.

Chairman PICKLE. Mr. Rangel?

Mr. RANGEL. Thank you, Mr. Chairman.

Welcome. Good luck to you, Commissioner.

Mr. GIBBS. Thank you. I will need it.

Mr. RANGEL. With these forms is it too difficult for you to have questions for the taxpayer to check off and ultimately find out how many exemptions he or she would have and then turn that over to the employer who knows the gross income and let him divide the exemption into the payment period, whether monthly or biweekly, and let the employers do some of your work?

Has that been thought of? Does it just sound too easy?

Mr. GIBBS. Congressman, we haven't exactly focused on that. One of the things we did take a look at was whether we could ask the employers to do more than they are doing at the present time. In terms of helping the employees complete their W-4 obligations, that is the thrust of your suggestion, I think. I think it is a good one. I must tell you we have already received comments from somebody in the Association of Employers asking us not to do that.

Mr. RANGEL. It seems like you gain a lot more friends from the employee who has to answer a lot of questions than on its face just don't make a lot of sense.

Mr. GIBBS. One of the things that has been pointed out to us we would have to deal with and perhaps we might be able to do so, would be to insure that we do not, in effect, force the employee to give the employer information that would be considered confidential. For example, if the employee is moonlighting, we surely don't want to turn that over to the employers.

Mr. RANGEL. Let me ask, that $17 million that you picked up during the reform bill, is that still around?

Mr. GIBBS. Congressman——

Mr. RANGEL. Remember when the Treasury and you came in and had to build up the trust fund with $17 billion? Is that still around?

Mr. GIBBS. I don't believe the trust fund proposals were implemented. I don't know whether the revenue was picked up in some other way.

Mr. RANGEL. What about this new $7 billion the President has found if he can make your shop more effective?

Mr. GIBBS. I think——

Mr. RANGEL. Can you verify those figures?

Mr. GIBBS. I think from the standpoint of the revenue estimates that we have been doing, Congressman, we are confident if the funds are provided, we will be able to provide the additional revenues. I think that confidence is shared by the Treasury and also by the Congressional Budget Office up here.

Mr. RANGEL. If we increase the funds that we would give you for employees and other more effective equipment, could you increase the revenues?

Mr. GIBBS. We have given responses to the chairman in terms of what we would do over a 5-year time period with additional resources, both to improve service and to improve revenue collections.

Mr. RANGEL. Do you remember what that figure was over 5 years?

Mr. GIBBS. I think over 5 years, assuming the maximum funding, the figure was at one time estimated at more than $30 billion over a 5-year period beginning in 1987.

Mr. RANGEL. Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Jacobs?

Mr. JACOBS. Thank you, Mr. Chairman.

Mr. Gibbs, I enjoyed your visit yesterday and the opportunity to chat with you and my prognosis for your tenure is very good.

I think we all expect good things of you, and I am grateful that a person of your competence is heading the principal domestic department of government in our country so far as the support of government is concerned.

Do you remember the initial name of this big tax law last year? Do you recall the name that was given to it by the administration?

Mr. GIBBS. The act that turned out to be the Tax Reform Act of 1986?

Mr. JACOBS. If that is what it turned out to be.

Mr. GIBBS. I don't remember the precise name, but as I recall, it basically was a law that was designed for simplicity, fairness, and promoting economic growth.

Mr. JACOBS. It was the Tax Equity and Simplification Act. The people, the working couples, two earner families, they lost what little amelioration they had from the marriage penalty in the final form of this new law, did they not?

Mr. GIBBS. Yes, sir. The two-earner married couple deduction is gone, although I think the idea was by reducing the rates you would compensate for it.

Mr. JACOBS. But, in fact, many of them will pay more taxes on the same income in consequence of the new act of Congress and the President, isn't that right?

Mr. GIBBS. That can well be. That, by the way, is also one of the problems in the W-4 area.

Mr. JACOBS. That is an example of the equity.

Now, we get to the simplification. As I recall, that word was pretty much dropped in the conference report, wasn't it, in the final form? Somehow or the other that was cast aside. They no longer called it a simplification effort, if I recall correctly, isn't that right?

Mr. GIBBS. I don't recall the dropping of simplification, Congressman.

Mr. JACOBS. Well, Mr. Commissioner, was the tax rate schedule one of the more complicated parts of our former Income Tax Code?

The notion was that by reducing the number of brackets, you had simplified the general Federal Income Tax Code. Do you remember that?

Mr. GIBBS. I was under the impression that it was really intended to address the fairness issues.

Mr. JACOBS. Oh, no. Time and again, we had testimony up here that, my goodness, all these brackets were so complicated and that is why people drank coffee late at night in the spring of the year, not anything else, not figuring formulas for deductions or exemptions or capital gains, anything like that.

That was child's play compared to this weltering—this welter of an obstacle course people had to go over to find out what bracket they were in. Was it all that complicated before the brackets were reduced in number?

Mr. GIBBS. Congressman, I don't know how to respond to that.

Mr. JACOBS. Did you consider that complicated, or was it more like going to the phone book and looking up Smith or Jones, just going to your bracket and finding out? It was Miller time when you got to the table, the tax table, wasn't it?

Mr. GIBBS. Having not prepared my return myself, I have never done that. I have given it to professional preparers. I don't prepare returns. I don't recall——

Mr. JACOBS. You just got to town. I will just ask one other question. You were not a Member of Congress who voted for this act, were you?

Mr. GIBBS. No, sir, I was not.

Mr. JACOBS. Then don't let them blame you too much about all the complications. You are the one who has been stationed out on the patrol ahead of the line there to meet the complaints about the new law. I think it was Bill Mauldin who did a cartoon which showed a man taking his son over to the defense plant on Saturday morning and explaining to the boy, "No, Daddy just invents the bombs. The smart men decide how to use them."

Now, if you reverse that, it may add something to the record for the edification of future Congresses, but I doubt it.

Thank you.

Chairman PICKLE. I believe Mr. McGrath has another question.

Mr. MCGRATH. Mr. Commissioner, one of the provisions of the Tax Reform Act requires that all partnerships, personal service corporations, and chapter S corporations, change from a fiscal year to a calendar year for the purposes of Federal income tax reporting.

I have heard from accountants all over the country and from people in your own department as to what kind of a burden this is going to create by having all of these returns dropped on you at one time. And the accountants must prepare all of these returns for individuals and all these other partnerships and chapter S corporations.

This was supposed to have been a revenue enhancing device that would have brought us some more money by having all of these returns filed contemporaneously.

What I hear from the accountants is that, because they are going to be deluged with all of this plus individual returns at the same time, that they are simply going to file extensions for everybody and, therefore, make moot the revenue enhancement effort that was the genesis of this particular section of the law.

I want to know from you whether or not I am correct in that assessment?

And number two, do you think we have a remedy or should this section just be repealed or should it just be—or should we perhaps in some case create a year's moratorium in order to find out a way that accountants can cope with this particular problem.

Mr. GIBBS. Congressman, I think that this particular problem may be a problem for the private sector. I am not sure it is a problem for us. Let me explain what I mean. People are still going to have to make their tax calculations by April 15 in order to pay any balance due or be sure they don't have anything due. The money will come into us with the extensions. We actually won't see the returns until they are filed.

So, from the standpoint of our service centers, if extensions are retained, we really will not be impacted the way I think the private sector will be impacted by this.

The other thing that I think might be helpful to the discussion would be to take a look at exactly how many fiscal year taxpayers, partnerships, subchapter S corporations, and so forth will be impacted by this.

In taking a look at that, my recollection is that although it may mean additional work for accountants, for tax return preparers, I am not sure that the numbers will actually be statistically significant for us at the Internal Revenue Service in terms of the number of returns that will be filed.

Mr. MCGRATH. What about us in terms of trying to create more money in order to make this effort as revenue neutral as possible?

Mr. GIBBS. From the standpoint——

Mr. MCGRATH. From our standpoint.

Mr. GIBBS. From the standpoint of this one time acceleration, as people move off fiscal years and on to calendar years, I don't recall what those figures are.

Mr. MCGRATH. I don't either, but it seems to make sense if they are going to ask for extensions, whatever revenue we expected to generate by this provision, it probably will not be generated.

I am just told it is $1.7 billion over 5 years.

Mr. GIBBS. I think, though, my point was the money will still basically come in. In other words, in order to request an extension, you still are going to have to make your tax payments by April 15. You will not file your return until the end of the extension period. But the money ought to come in to the Government. So, I am not sure what the impact will be on the revenue side.

Mr. MCGRATH. Mr. Chairman, I have one further question that has to do with another problem that has surfaced as a result of a conversion of S&L's from mutual to stock institutions.

I was alerted by an S&L in my district, the Anchor Savings Bank, which has become a phoenix for those S&L's in New York State that have failed.

They have taken in 13 over the last five years and accumulated about $375 million in NOL's through those transactions.

The actuarial form gave to thrifts a two-year window for these conversions before there would be any further limitations of the NOL's.

However, in another section of the committee report, a footnote indicates that the underwriting must be done, if it is done on a

firm commitment basis. This may inadvertently trigger a technical change in ownership.

In my judgment, the underwriters are just a passthrough situation and should not be subject to this change of ownership section.

In this particular case, with the Anchor Savings Bank, because they are going through a change from a mutual to a stock at this particular point in time, they could lose their $375 million in NOL's and probably never take over another S&L that may fail.

I don't think that is fair. I don't think it was the intention of the law, and frankly, we are in a double park situation, because they are in a time frame now where they are converting.

I would just hope that you and Treasury and we could get together to at least issue some kind of a statement so that the Anchor Savings Bank will not lose its NOL's and at the same time be available to the FSLIC to take over failing institutions.

Mr. GIBBS. Congressman, earlier this week, I had several letters concerning this problem, and I have passed that correspondence on to the Assistant Secretary of the Treasury for Tax Policy, Roger Mentz, and also to our Chief Counsel, Will Nelson. It is something that we will get into. We are already into it.

Mr. MCGRATH. Thank you, Mr. Chairman.

Chairman PICKLE. The Chair would ask that we try to stay with the schedule we have outlined here about specific fields of inquiry and not the broad field.

I want to go on to another subject, Mr. Commissioner.

Before we do, let me review for you some of the things it seems like have come out of this hearing this morning.

Number one, you have indicated you are going to produce a new W-4 form. At least you are studying it. You will make that decision within the next few weeks.

I want to ask you again, do you anticipate that you will have a new W-4 form produced?

Mr. GIBBS. Mr. Chairman, that is the decision of the day. I am hopeful——

Chairman PICKLE. I know that is the decision. I am trying to get you to say whether or not you are going to produce one. You don't know now?

Mr. GIBBS. I don't know. Let me explain why I don't know.

The reason I don't know is because we are developing a form that is clearly simpler. The problem at this point with the way the form is prepared is that it is also less accurate to the point that we are concerned about it.

Chairman PICKLE. You have to decide do you want simplicity or accuracy. What are you going to do? Your decision is not that you need more information. You just need to make a decision.

Mr. GIBBS. What we need to do is try to adapt the form to accommodate the need for both simplicity and accuracy.

Chairman PICKLE. What can we expect? If you have a new form, will you have one recommended by March 1?

Mr. GIBBS. I am hopeful that we will, yes. Literally, we are working to get it out.

Chairman PICKLE. Is that a reasonable target date to think if you have a new one, it would be by then?

Mr. GIBBS. I think it would be.

Chairman PICKLE. You have already indicated that you are going to forego the penalties if it is filled out in good intent? It seems to me that is going to say to the public, "You don't have to get this form, anyway. We are not going to have to pay the penalty. Don't worry about that."

That is an open invitation not to file unless you get this form out. If you are going to get a new one out, all I ask is that you do it soon. All you have to do is make a decision.

I would agree with you—you have to make a decision as to whether you want accuracy, as we in the Congress almost mandated you to have, 90 percent compliance, or are you going to just have simplicity for the sake of quickness?

You have to make that decision. You don't need an accumulation of a lot more study and fact. You have to make a decision. I ask you to do that as quickly as you can.

Mr. GIBBS. I will, Mr. Chairman.

On the penalty issue, let me mention the reason I want to come back with a specific proposal is, obviously, we need to take care of the taxpayers who have made a legitimate effort to attempt to comply, but we sure don't want to set up something that gives people a free license to do nothing.

Chairman PICKLE. We would all agree with that. This is in the middle of February. Filing season is already underway. A decision must be made. So, we would say if you are going to do it, then do it. Let's do it as soon as possible.

I want to get into a second area of inquiry, the 1987 tax filing season. Let me ask you, why is it taxpayers are filing later than they used to? Can you give me an indication of why?

Mr. GIBBS. Mr. Chairman, I really do not know. I know this is a trend that has been continuing over several years. I don't honestly know. I don't think we have done the analysis. I don't know that we could tell you why this is actually happening.

Chairman PICKLE. You are processing quicker but fewer people are filing. You don't know why. Give some indication to our committee, if you will, of why you think that is happening? I think that is important for us to know.

Mr. GIBBS. Let us see if we can provide a response to you on that point.

[The following was subsequently received:]

CAUSES OF LATE FILING

According to a 1986 public opinion survey conducted by the Roper Organization on behalf of H&R Block, about one in five of the individuals interviewed indicated they filed their return later than in past years. Of these respondents, 34 percent cited procrastination for their lateness in filing while 13 percent delayed because they had balance due returns. Some of the other reasons cited by less than one in ten of later filers included problems getting tax information, problems obtaining tax forms, and various other miscellaneous reasons.

Chairman PICKLE. Are the service centers adequately staffed for this year?

Mr. GIBBS. As I indicated, with our staffing this year, and in the absence of problems that we don't anticipate, I think that the staffing is adequate this year.

Chairman PICKLE. Do you have a sufficient number of old employees or are the centers staffed with more new employees than in previous years?

Mr. GIBBS. I think last year about 65 percent of our seasonal employees were new employees. My understanding is we are hopeful there will be fewer this year, but perhaps around that range.

Chairman PICKLE. In my city of Austin, in the service center, last year we had almost 90 percent new employees. What will that percentage be for the 1987 filing season? Do you know?

Mr. GIBBS. I think it is going to be less than that.

By the way, in Austin, we are doing quite a bit better than we have done in previous years in terms of being able to recruit and obtain really good people to go into the service center there.

Chairman PICKLE. I am glad to hear that. They are capable people there, I am sure.

May I assume that on average over the various centers, about 65 percent of the people will be new employees?

Mr. GIBBS. Yes, that is basically what we are talking about. Let me see if I can, in Austin—looks like about the same to the national average.

Chairman PICKLE. Give us those figures.

Commissioner, I would like to have the number of new employees in all the centers as of the filing season.

Mr. GIBBS. We will furnish that to you, Mr. Chairman.

[The following was subsequently received:]

SERVICE CENTER HIRING

During FY 1986 it is estimated that about 65 percent of total service center seasonal employees were new hires. The variation from center to center and from position to position was broad, ranging from about 50 percent to over 90 percent (this data is reflected in the first two columns of the chart below). Although we will not have data until late April, we do not expect that these percentages will change appreciably in FY 1987 as resource needs currently appear to be stabilizing. In fact, because of an increase in permanent employees in some areas, there may be some decline in new hire percentages.

In 1987, our projected hiring goal for input function positions is nearly 10 percent below the comparable number of actual hires for 1986 (this data is reflected in the two right columns in the chart below). This is in part due to increases in permanent positions, as noted.

Although the overall new hire goal for input functions is smaller, the projected goal for Data Transcribers (the largest single source of new hires) in 1987 is about 10 percent greater than in 1986.

While seasonal and new hire needs seem to be leveling out this year, recruitment and retention continue to be significant concerns, especially for Data Transcribers. Hectic and demanding conditions at uncompetitive wages still prevail for entry level positions. Unemployment rates remain low and private sector competition for employees remains high. By late April or early May we should have data that reflects the relative difficulty we encounter in hiring this year.

Centers	1986 Seasonal New Hires	1986 % of Seasonal New Hires	Major New Hire Categories 1986	1987
ANSC	2280	80%	2270	1430
ATSC	2491	79%	1870	2327
AUSC	3000	91%	2175	2194
BSC	1751	57%	1407	1545
CSC	1563	61%	1345	1409
FSC	2522	61%	2023	1249
KCSC	1374	58%	1542	1279
MSC	1362	51%	1072	891
OSC	1792	60%	1804	1152
PSC	1675	49%	1456	1511
TOTAL	19810	65%	16964	14987

Chairman PICKLE. Regarding inventory, I notice in your testimony that you go into some detail about adjustment inventory, and unpostable inventory, and the marked decrease, 50, 55 percent in those areas, however, you didn't say anything about accounts receivable.

I am advised that your accounts receivable inventory now is at a high level of $48 billion as I noted in my opening statement. That means an increase from $25 billion in 1982 to $48 billion. Why do we have that much outstanding in the accounts receivable? That is $48 billion that individuals owe the Government, and we know it.

All you have to do is go get it.

Mr. GIBBS. Mr. Chairman, when I came in as Commissioner, one of the first things that I did was to convene a task force to take a look at that issue. I am concerned about it. They have gone up.

We are still in the process of analyzing the accounts receivable. What we found was this: there are two factors that over the last several years have caused those accounts receivable to go up. We are concerned that some of the accounts, things that we are showing as accounts receivable are not valid accounts receivable.

Let me explain that. The Federal tax deposit process, where employers are sending in their Federal tax deposits, has been a problem for us, largely because of some of the information that is on the form simply is incorrect, and it causes us to credit payments that the employers are making to the wrong account.

As a result, we generate bills to those employers when we think they haven't paid, but actually they have, because we have it credited to the wrong account.

What we have been doing in the last 6 months is to go back and match the amounts that have been paid to us that are credited to the wrong account with the bills we sent out, before we discovered the errors.

We are finding that we literally have billions of dollars where we are——

Chairman PICKLE. Are you saying, then, you do not have $47 billion in accounts receivable?

Mr. GIBBS. In analyzing our accounts receivable at the present time, we believe that the accounts receivable may be overstated by——

Chairman PICKLE. How much?

Mr. GIBBS [continuing]. By as much as $4 billion to $6 billion, and we are trying at this time——

Chairman PICKLE. I didn't understand. As much as how much?

Mr. GIBBS. By $4 to $6 billion. Let me explain. That is not due solely to Federal tax deposits. Mr. Chairman, this is part of the runoff of the 1985 filing season.

Chairman PICKLE. Mr. Commissioner, let's assume it is $4 billion, just to give you that. That would still leave $43 billion. You have $43 billion that is out there and owed to the Government that we don't have. Why don't you go get it?

Mr. GIBBS. Mr. Chairman, with the resources that you were good enough to help us get, one of the things that we have shown from 1982 to the present time is that collections have increased by almost 35 percent. We are collecting the money, and if we have more resources, we will collect more taxes.

But it is not a situation where those accounts receivable are building and we are not collecting the money. Indeed, we are collecting the money.

Chairman PICKLE. I know it is not easy or you would have done it. However, if it is out there, it seems to me we ought to have an accounting of why you haven't collected it. I want you to give this committee more information. That money will take a big bite out of the deficit.

You don't have the manpower to collect it? You don't have the money? People are gone? They died? What?

Mr. GIBBS. We have a breakdown of our accounts receivable inventory. We can tell you what we think is actually collectible, once we eliminate the problems that we have. We can also tell you, with additional revenue officers, how much we think we can collect.

Chairman PICKLE. That will be fine.

[The following was subsequently received:]

ACCOUNTS RECEIVABLE
Fiscal Year 1986

Category	Number (000's)	Amount ($000,000)
Notices	N/A	$13,661
Taxpayer Delinquent Accounts	1,938	11,922
Installment Agreements	611	777
Currently Not Collectible	2,887	8,995
Deferred	2,552	392
Other System Monitored (e.g. Bankruptcy, litigation)	N/A	6,152
Total Delinquent Accounts		$41,899
Current and Nondelinquent Accounts -		$ 5,746
Total Accounts Receivable -		$47,645

We estimate that collections of delinquent taxes will total $21.7 billion in FY 1987, an increase of 10% from our FY 1986 collections of $19.6 billion. For FY 1988, we are estimating total collections to increase another 10% to $23.9 billion.

These increases are due to the increased resources in our Collection function and to increased efficiency of our collection operations.

Even though the Internal Revenue Service has increased the amount of money collected from delinquent accounts significantly over the last five years, we are constantly searching for better ways to collect delinquent accounts and manage our inventory. During the past year, for example, we implemented a Workload Priority and Selection System in our Collection division which assigns the highest priority to those cases with the greatest yield potential. In our service centers we have revised procedures to focus our attention on high dollar cases which has led to a reduction in our inventory of adjustment and unpostable cases.

The growth in the accounts receivable also reflects our stepped up efforts to improve compliance. The inventory today includes many taxpayers whose liabilities previously were not identified.

There are many steps in the process of collecting accounts receivable from the time a taxpayer files a return with a balance due. The Internal Revenue Code requires, in ordinary situations, that we not take any collection action until ten days after the balance due notice. Our processing includes issuing follow up notices on accounts unpaid after the first billing. We are also required to suspend collection activity on accounts involved in bankruptcy or other litigation. The Service defers active collection on accounts where it would not be cost effective to assign to a field office. We also suspend collection on accounts that we have determined to be currently not collectible or while we research a missing payment.

We have created a special group composed of representatives of all the functional areas involved with accounts receivable. This group is studying both the causes of the growth in accounts receivable and improvements we can make at every step of the collection process to better manage the inventory. The reduction in unpostable and adjustment inventories in our centers that I mentioned earlier is partially due to recommendations made by the task force. We will continue to pursue methods of controlling the growth in accounts receivable and increasing the amount of unpaid taxes collected.

Chairman PICKLE. Mr. McGrath?

Mr. MCGRATH. No more questions.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

I apologize for being late, but I had to be in Pennsylvania this morning.

Mr. Commissioner, I appreciate your coming to testify before us this morning, your first oversight hearing for the 100th Congress.

Some of the questions which I had have already been answered, but let me ask a question or two about the W-4.

Mr. Commissioner, did the Service test the W-4? Did you have a test group that you tried out the W-4 before it was issued?

Mr. GIBBS. Congressman, we did. We tested it within the timeframe that we had to get it out in order to have it out, in the hands of employees and employers near the end of last year other first of this year.

We tested it by doing the following. We took it to several of our service centers so that we would not be using people who necessarily had technical expertise in the tax area.

As you know, in our service centers they tend to be low- to middle-income folks. They are not tax specialists. We actually took the form out and without any help from anyone, basically let the employees complete the forms and then made certain adjustments, changes, and got feedback in terms of difficulties that people were having.

So, we did test it and, frankly, we tested it both for accuracy and for understandability. The test itself indicated that there was some additional difficulty with the form which we recognized at the time we put it out, and I said at the time we put it out it was going to be a more complex form.

There was some confusion. But we found that people, at least within the service centers where we tested it, could cope with that complexity.

What we have also found as we have begun to try to develop an alternative is that there are much more sophisticated and extensive devices that we could use and we are using those with respect to the form that we are working on at the present time.

Mr. SCHULZE. So the test group was actually IRS employees, not a cross-section of taxpayers?

Mr. GIBBS. That is correct, Congressman.

Mr. SCHULZE. What about the length of time it took to fill out the form? Was that a factor or did you just look at ease and understandability?

Mr. GIBBS. Congressman, I do not recall whether we actually tested that. I will provide that answer for the record, but I do not recall whether we actually tested the length of time that it took to fill it out.

[The following was subsequently received:]

FORM W-4 TESTING

While we did not record the actual time it took each participant to complete the Form W-4, those monitoring the testing process recollect that for the simplest test situation, most people completed the form in 15 to 20 minutes. For the more com-

plex test situations, the average time for completion was 30 to 45 minutes. All participants were able to complete the examples in less then one hour.

It should be noted that for test purposes the Service used hypothetical tax situations so that the results could be evaluated more readily. Many test participants voluntarily mentioned they could have completed the form in less time and with less difficulty had they been permitted to use their own more familiar tax facts.

Mr. SCHULZE. As a suggestion in the future I believe you could do some of this with IRS employees, but I would strongly recommend that we go outside of the Service and try to take a group of average taxpayers rather than IRS employees who are somewhat oriented to taxes and forms.

Mr. GIBBS. Congressman, I agree with you. That is what we are doing at the present time.

Mr. SCHULZE. I apologize if this is redundant, but how many W-4's have come in? Are they coming in?

Mr. GIBBS. We have some very, very preliminary information on that. We have gone out and actually contacted about 90 companies. It is not a statistically valid sample, but it is at least some indication. You will be interested to know that most employers had received the W-4 and the withholding tables, and had distributed them. We have about, I would say, 25 percent of the 90 organizations that indicate that 20 percent or more of their employees have filed the forms.

In our own organization, in the Internal Revenue Service, we have also looked at that, and we find that approximately double that amount have returned the form at the present time. We will continue to try to monitor how the forms are coming in.

Chairman PICKLE. Mr. Schulze, will you yield?

Mr. SCHULZE. I certainly will.

Chairman PICKLE. Are you saying approximately 20 percent of the people have filed the W-4 forms now?

Mr. GIBBS. I think that is right, Mr. Chairman. I will check that.

[The following was subsequently received:]

SURVEY FINDINGS

The survey of 90 large organizations showed: 89 percent had received the new Circular E and Form W-4; 93 percent had implemented the new withholding tables; 74 percent had distributed the new Form W-4 to their employees; and 33 percent had established target dates prior to October 1, 1987 for return of the Forms W-4.

Only 71 of the 90 organizations had information available on the number of employees who had returned the Form: 25 of the 71 organizations (35 percent) indicated that 20 percent or more of their employees had returned the Form (range from 20 percent to 100 percent); and 16 percent of the 734,000 people employed by the 71 organizations had returned the Form.

Chairman PICKLE. How does that compare to the W-4 of the 1986 season?

Mr. GIBBS. Mr. Chairman, this is one of our problems. This is only the third time in history that completing a W-4 has been required. When the W-4 was introduced in 1943, everybody had to fill it out. In 1966, when we went to graduated withholding, everybody had to fill it out. In 1986, everybody is having to fill it out.

One of the things, again, with the W-4 that we are finding is that for years people have just filled out their W-4 and kind of left it. They haven't touched it. One of the things that we are finding now is that as people have to fill it out, they are focusing on things they haven't focused on for years.

Chairman PICKLE. I am trying to understand. Can you give me a reason why they did or didn't fill out the forms? How many W-4 forms were submitted in 1986 at about this same time?

Mr. GIBBS. We have no way of monitoring that.

Chairman PICKLE. You are saying very few?

Mr. GIBBS. We don't know. The W-4's are given to the employers by the employees. They don't come to us.

Chairman PICKLE. So you just wouldn't know?

Mr. GIBBS. That is correct.

Chairman PICKLE. At least 20 percent are filing it. Is that discouraging or encouraging?

Mr. GIBBS. I would have hoped for more, but in the sample, we are talking about only 1 month's time for people to do it. We had heard talk that nobody was doing it to around a range of 20 to 25 percent. I have been told the range was 20 to 25 percent of the companies we sampled.

Mr. SCHULZE. Larry, let me say if it is that high, then I think that is a great achievement.

The chairman was inquiring about the accounts receivable. Along that line, have you considered the use of credit cards for accounts receivable? Have you considered it and rejected it?

Are you still considering it? I would like to have your thoughts.

Mr. GIBBS. Congressman Schulze, it is under consideration both at the Internal Revenue Service and at the Treasury Department. We are taking a look to see what revenue impact, if any, it would have in terms of accelerating the collection of receivables.

We are also looking at how it would work, and again, the concept here is certainly not to encourage anyone who does not wish to do so to use a credit card. We are not trying to do that at all.

All we are saying is that we know there are taxpayers in this country who have the financial capacity to go to banks and borrowers. There may be other taxpayers in this country less affluent, who don't have that capacity.

Their credit means are with credit card companies. All we are trying to do is provide more of an opportunity, if they wish to avail themselves of it, if it otherwise seems like a good idea, for people to be able to do that.

Mr. SCHULZE. Has it gone far enough that you have actually negotiated with any of the credit card companies as to percentages or rates? And if not, do you have any thoughts on that?

It seems to me that it might be well to appeal to them to see if that could be done without charge to the IRS rather than there being a discount on it. But I don't know whether that has been broached.

Mr. GIBBS. Congressman, we have not, because the legislation has not been finally approved and endorsed. We have not, for that reason, actually gone to credit card companies, because we don't really have anything to negotiate at the present time.

We have to educate ourselves about this, and we have reason to believe that we would have a very good opportunity to use this type of arrangement without any substantial cost, if any, to the Federal Government.

Mr. SCHULZE. Perhaps it might be well to have some informal discussions with them to explore it, and find out whether it is worth looking into.

Mr. Chairman, with your indulgence, I would like to ask a question or two about procurement.

Chairman PICKLE. We are going into two other general fields. Then you may ask those questions. Let us get into the next area here, tax reform implementation. Is that agreeable?

Mr. SCHULZE. Fine.

Chairman PICKLE. On the credit card aspect, Commissioner, I would like to know, you do not intend to have any credit card implementation during the 1987 filing season? You do or don't?

Mr. GIBBS. Do not, Mr. Chairman, because it will require legislation in order to be able to go forward.

Chairman PICKLE. You don't anticipate it during 1987?

Mr. GIBBS. No, sir.

Chairman PICKLE. We have two other fields to cover, and then any members can ask any other questions they want to. We do have three other groups to be heard from, the General Accounting Office, and then we have a panel of two former Commissioners, Mortimer Caplin and Donald Alexander, who are here.

As soon as we finish with this line of questions with you, I hope you might be able to stay. If we talk or interrogate these individuals, we may want to have questions for you to answer, and we would hope you or your representatives can stay with us.

Quickly, on tax reform implementation, has the Internal Revenue Service indentified all of the changes it needs to make to implement tax reform?

Mr. GIBBS. We have, Mr. Chairman. One of the things that, as an agency, we have done over the last 10 years is to identify, as an act is passed, all of the matters that have to be addressed within the agency, in order to be able to carry out the provisions of the new act. We have done that within the Internal Revenue Service on this act.

Chairman PICKLE. Other than the W-4 forms, which we seem to be concentrating on almost entirely, has the Internal Revenue Service identified any other provisions of tax reform that will constitute a serious problem for us?

Mr. GIBBS. I wouldn't call it a serious problem, but one of the things that the W-4 form has taught me is that any time you have a new form or new procedure that affects a large number of taxpayers, you need to be sensitive to how you go about communicating and implementing that form or provision.

We do have one coming up that will be applicable to taxpayers when they file their returns next year. If you will recall, taxpayers will have to have a social security number for dependents over the age of 4, I believe, in order to be able to claim the dependent as a deduction.

That is going to require communication with the taxpayers this year, and it will require many taxpayers to obtain social security numbers for their children in order to be able to claim them as dependents.

Chairman PICKLE. Now that we have a new tax reform measure and it is the law, you are going to have to reprogram many of the

computer programs. Have you reprogramed them now? Do you anticipate any difficulties?

I gather from your statement that you have reprogramed for this filing season and caught up, but have you reprogramed for the new season?

Mr. GIBBS. We are in the process of doing that.

Chairman PICKLE. How far along are you?

Mr. GIBBS. We have reprogramed some, but we are really in the preliminary stages. The EDS report that I mentioned a minute ago urged us to be aware of the reprogramming we would have to do for our computers by no later than the end of this month, in terms of at least knowing what the amount would be.

They are not suggesting we actually do the reprogramming, but they said the first step is to know what reprogramming will have to be done. We have already gone to all of the areas within the Service and asked them by the end of this month to provide our computer services people with an indication of where the reprogramming will have to take place.

The other thing that we are doing, Mr. Chairman, is that we are actually working backwards. We want to be in as good a shape next year at this time as we are this year at this time, and what we are doing is working backwards and establishing deadlines that have to occur, so that we can get our reprogramming done, we can get our manuals written, we can get the training done, all of the things that have to go into a successful filing season. We are starting right now to do that.

Chairman PICKLE. I am encouraged that with the new tax reform bill you have not had more inquiries or protestations about the new tax system than you have had. Since the bulk of your complaints were on the W-4 form, it would seem the public is adjusting satisfactorily to the fact we do have a new bill. You are getting your W-4 form in shape. I hope that that is correct. If you have any problems other than the W-4, we hope you make an immediate decision on them.

Mr. McGrath.

Mr. MCGRATH. Thank you, Mr. Chairman. Just one question. If we are having the kinds of problems that are being exhibited with the W-4 form and the instructions, then what can we expect with the form 1040?

Mr. GIBBS. Congressman, I have been asked that question a number of times. One of the things that we have already begun to do with our tax forms is to take a look—and this is fairly early in the year to do this, usually it would be about the middle of the year—but we are actually taking a look to see what kind of an impact the new act is going to have on our forms.

I will tell you this: my own opinion is that the forms themselves are probably not going to be where the impact of the act is felt most. I think it is going to be on the instructions. In other words, not what the form looks like, but what do you fill in the blanks on the form.

Mr. MCGRATH. That is the problem with the W-4.

Mr. GIBBS. You are right. As a result, what we are doing is to actually attempt now to establish the deadlines for drafts early on, so that we can work on the publication and particularly on the in-

structions to try to address that. Again, what we are trying to do is work backwards from when those forms have to be in people's hands, to see with respect to each form what the deadlines are for writing the instructions so that we can review them.

Mr. McGRATH. This would be true for all other forms that would be attachments to the form 1040.

Mr. GIBBS. 500 forms.

Chairman PICKLE. Mr. Schulze?

Mr. SCHULZE. Mr. Chairman, have we gone into computers?

Chairman PICKLE. That will be the next item.

Mr. SCHULZE. I will wait until we get into computers.

Chairman PICKLE. If we don't have other questions, I suggest we get into the computer area now. Commissioner, you have indicated that you had new programming, that you are ahead of schedule, and that 1986 was a better filing season.

In my statement at the beginning, I pointed out that the front-end processors were the weak link in the whole chain of operations from the terminal to the main frame. We were going to get new front-end processors.

I ask you, are the new ones which we provided funds for in place or not?

Mr. GIBBS. Mr. Chairman, they are not in place. As I came to the Service in August, one of the things that I found was that, despite a contract that we had signed that required those new front-end processors to begin testing before I arrived, the contractual provisions had not been fulfilled.

The front-end processors were not being tested; and indeed, the test did not begin until later in the fall. When we ran the tests——

Chairman PICKLE. Will they start in the fall?

Mr. GIBBS. When we ran the tests last fall, they did not meet the requirements that we had previously set. I have met personally with the head of the company that has principal responsibility for the front-end processors as well as the key officers of all of the subcontractors, and have expressed my concern.

In addition, when the testing did not work, we issued a letter indicating that the contractor was in default. We have been in almost constant negotiations with the contractor.

We think we have a new approach to address the deficiencies that caused the front-end processors, the new ones, to be unacceptable to us; and we are anticipating that we will actually begin to test those this summer, which would make it about a year late by comparison to what it was supposed to be.

Chairman PICKLE. If you are not going to test them until this summer—that would be an early schedule—that means then that the new front-end processors will not be in operation for this 1987 filing season at all?

Mr. GIBBS. That is correct. The processors themselves will not. We will have some new terminals in some of the areas, in some of the centers where they don't have capacity problems, and outside the centers.

Chairman PICKLE. Will you have new terminals which are attuned to the new front-end processors or to the old ones, or both?

Mr. GIBBS. Yes, both.

Mr. McGRATH. Will the gentleman yield?

Chairman PICKLE. Yes.

Mr. MCGRATH. I have heard of the problems with the front-end processors. Now, this is probably the third straight year. Are we still dealing with the same contractor as we have been dealing with over the last several years? Or do we have a new one?

Mr. GIBBS. It is a new contractor. The original contract was signed with another one. Then we signed a new contract with this contractor in February of last year.

Mr. MCGRATH. Since we are having all these problems, it has caused a delay in the installation What kind of penalties or damages have we assessed on these contractors over the last number of years?

Mr. GIBBS. There are liquidated damages clauses for this. As I recall, they have been close to $500,000, between $450,000 and $500,000. The important thing is that when they did not meet the testing, we simply stopped paying.

What we have paid for, in terms of the negotiations, we are going to get. We are not going to pay for things twice. The point is that while we have some liquidated damages, we also have not been paying out anything on the contract and anything we paid previously, we will get credit for against the new price.

Chairman PICKLE. Commissioner, you started off with one contractor, and they did not meet the requirements, it was not operating, so you terminated that contract. I understand it cost us about $40 million in the process.

Now you have a new contractor. I understand it is really difficult—there are real difficulties between that contractor and the subcontractor. A storm is brewing as to who is responsible for what. Your testimony is you think with this new contractor, nevertheless, you will be able to have testing started by this summer?

Mr. GIBBS. That is what we are anticipating at this time, yes.

Chairman PICKLE. What bothers me, I am trying to look at the long picture. We are supposed to have new front-end processors. You bought them. Have you bought all the new replacements? Are they purchased?

Mr. GIBBS. We have contracted for them. They have not been delivered, so we haven't paid for them.

Chairman PICKLE. If we don't have them, even though you have contracted for them it is not likely you will have your front-end processors soon. Certainly not in 1987. You indicated the old one can still function until 1990.

I understand some of you down the street are saying you might want to stretch that out to 1994. Is that correct?

Mr. GIBBS. On the front-end processor, no, sir. We want that as quickly as we can get it.

Chairman PICKLE. The public expects your front-end processors to be operational and in place. When can we expect that?

Mr. GIBBS. I thought I had very little hair when I came in, but this has caused a lot more of it to leave. In terms of trying to give you assurance, I can tell you what we are doing.

We signed a contract last February. That contract was not fulfilled. Our alternative at that point was the same alternative we faced last year about this time, and that was whether to start all over with someone else where you had a minimum of 20 to 30

months that you knew about, or to continue with the contractor that you had.

We think we are now monitoring on virtually a daily or weekly basis what the contractor is doing. We have reason to believe that what the contractor is now doing and the quality of people that are now working on the problem is such that we will get those computers.

Chairman PICKLE. It would seem to me, Commissioner, this committee has reason to be not only concerned, but even frightened that the front-end processors may not be in place in time. It seems to me that is a very serious problem, and some greater emphasis should be put on it.

As long as we postpone the new processors, that means the old terminals are getting older; that means higher maintenance costs, and we could get to a point that we will have a repeat of the 1985 season in another year or two, if we don't get this straightened out.

At this point, I know you recognize the seriousness of it, I am going to ask to have another hearing in perhaps a month to see what progress has been made. That problem must be attended to.

Mr. GIBBS. Fine.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Let me say this reflects very poorly on the ability of the Service to procure computers. We have a new large procurement coming. I realize it is not necessarily on your watch, but you are going to have to bend over backwards, especially with the tax system redesign procurement coming up.

Can you tell me what you are doing to make sure this does not happen again? As I say, I realize there was a court decision and other things. But despite that, it has not been handled well. You cannot do this in the future. I want to know what you are doing to make sure it does not happen in the future.

Mr. GIBBS. Congressman, I wonder if we could distinguish between two things. I really have gotten into I think what you are referring to in terms of the original procurement with the prior contract.

I would like to separate that, quite honestly, from the problems we are having now because it seems to me that when you do sit down——

Mr. SCHULZE. Let me interrupt you. I could dispute that because I think that was mishandled by the Service. In spite of what the court said and on how that new contract was let, I could argue with you on how that was handled.

Mr. GIBBS. All right.

Mr. SCHULZE. That is why I say I don't want to get into it but I say it has not been handled well. Somehow you have to look at this and say by George, that is not going to happen in the future. That is why I want to know how you will handle it.

Mr. GIBBS. Let me talk about what we are doing in the procurement area. One of the things we have done in the last year, Congressman, is to go out and actually upgrade the people that are working in our procurement area.

We have elevated it within the organization. That means that we have higher graded positions, which means frankly that we can

offer more money and we have been trying to attract people with more experience in the area.

We recognize that in our contracting and procurement area this is something that we need, with the automated data processing projects that we have coming on down the line.

The second thing that we are doing is that we are beginning to work towards our tax system redesign on projects that are increasingly more ambitious, so we are not starting off with the most ambitious one first. We have worked through the automated collection system and have done a good job there. We are now into our automated examination system, another major procurement that is going well.

We are shortly going to be into our integrated collection system. Each one of those gets progressively larger and more complex. We really feel with our new personnel and the emphasis we are giving it, with the way the other projects are going, that we are making progress in this area. One of the things that I know as a former practicing attorney is that when you get a situation where people sign contracts and then don't live up to the terms of the contract, you can certainly go back and second-guess yourself about the selectivity process and so forth.

That is a problem that hopefully won't happen to us again. I think we need to do the things that you suggest to avoid that. I am also hopeful that we won't get into a situation where we have someone who defaults on a contract.

Mr. SCHULZE. That is encouraging and sounds good and I think that is probably the right route to go, but let me assure you this committee is going to be looking over your shoulder so don't rest on your oars. Keep going and make sure it continues to go well.

Thank you, Mr. Chairman.

Chairman PICKLE. May I make an addenda to that observation Mr. Schulze has made? The IRS has got two front-end processors in reserve, extra. So if you had a breakdown you could step in.

Mr. GIBBS. Yes.

Chairman PICKLE. Suppose you had three or four of those computers break down? What are you going to do then? You got to keep in mind that those front-end processors are 15, 16 years old, many of them. If there is no resolution of this change over problem and it were to stretch out another 3, 4, 5 years, then those old computers would be 20 years old. That is frightening.

So it seems to me, Commissioner, that Mr. Schulze makes a point and I am just saying to you that is one of the most serious problems we have in the processing of all these forms and it is not just an old concern.

I am saying that I am directing you to get this mess straightened out on the front-end processors and we will stay after you hard and fast.

Mr. GIBBS. I hear you, Mr. Chairman.

Chairman PICKLE. Any other questions. Commissioner, we are going to ask you just rest and relax for a few minutes if you will and stay with us. We want to get to some other testimony. I know this is lengthy but we think it is very important. Can you do that?

Mr. GIBBS. Surely.

Chairman PICKLE. I will call up as our next witness, James R. Watts, Associate Director, Information Management and Technology Division of the General Accounting Office.

Mr. Watts, if you will please come forward. Then we will have the panel between the two IRS Commissioners. We look forward to that.

Mr. Watts, we are pleased to have you here. We are sorry that we are slow in getting to your testimony but I know you will give us some good testimony. We are pleased to recognize you. Will you please identify the gentlemen with you?

STATEMENT OF JAMES R. WATTS, ASSOCIATE DIRECTOR, INFORMATION MANAGEMENT AND TECHNOLOGY DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY TED GONTER, GROUP DIRECTOR, AND RICK HILLMAN AND MARK GILLEN, AUDIT MANAGERS

Mr. WATTS. Yes, I will, sir. On my right is Ted Gonter, group director, who is primarily responsible for looking at computer technology issues at the IRS.

My point man over here, Rick Hillman, is one of our audit managers who works in that area. On my immediate left is Mark Gillen, also an audit manager for us.

Chairman PICKLE. I will ask that you speak a little louder into the microphone if you will, please.

Mr. WATTS. Yes, sir, I will.

Mr. Chairman, and members of the subcommittee, we are pleased to be here today to provide information on the Internal Revenue Service's computer systems. These systems are critical to processing tax returns, answering taxpayer inquiries, and issuing refunds. The computer issues we will discuss are the focus of two recent GAO reports.

In these reports we made recommendations to IRS that we believe are essential to ensuring that computer resources adequately support the successful processing of tax returns in this filing season and in the future. I will briefly summarize these reports and provide you with the current status of these issues and IRS' actions on our recommendations. I will also discuss how well IRS' computers have supported tax return processing during the first month of the 1987 filing season and comment on the objectives and status of the tax system redesign project.

As we all know, IRS is highly dependent on computers to support its mission. The proper management of these resources is crucial for the timely processing of about 180 million tax returns annually and for ensuring that the Nation's tax laws are administered efficiently and effectively.

I would like to direct your attention to the chart. It shows the computers I want to discuss. These computers are located in the 10 service centers which process your tax returns.

Once your returns are received, an IRS employee uses a computer terminal to enter data from your return onto a small computer which in turn produces a computer tape containing your tax return information. These tapes are then processed on very large computers which I will refer to as mainframes in my testimony today.

The mainframes check your tax return for mathematical accuracy and completeness. If everything is OK your tax return information is put on another tape and sent to the IRS national computer center in Martinsburg, WV, to update your official records.

If for some reason, however, an error is detected, then your return information is loaded on to another tape and put on another mainframe at the service center.

Employees using computer terminals work to correct those errors. Employees also use these terminals to access information on the mainframes so they can respond to your taxpayer inquiries.

One important thing to note: each service center has about 700 to 900 terminals that must go through the front-end processor to get at the information on the mainframes. If the front-end does go down, then the employees cannot effectively do their jobs of correcting errors and responding to taxpayer inquiries. Also note that each service center has two large mainframes and only one front-end processor.

With this brief overview, I would like to return to my prepared statement and discuss first our report on the front-end processors.

Chairman PICKLE. You are saying if a front-end processor breaks down, she backs up and gets clogged and stops?

Mr. WATTS. Yes, sir.

Chairman PICKLE. Practically speaking.

Mr. WATTS. Yes.

Chairman PICKLE. All right. Thank you.

Mr. WATTS. IRS' current front-end processors and some of the computer terminals are old.

Chairman PICKLE. Tell us where you are resuming.

Mr. WATTS. I am at the bottom of the first page. I diverted to discuss the chart.

Chairman PICKLE. All right. Go ahead.

Mr. WATTS. I am beginning at the top of the second page in the middle of the paragraph, sir.

The current front-end processors and some of the computer terminals are old and susceptible to reliability and capacity problems. To correct these problems, in February 1986, IRS awarded a contract for about $150 million to replace this equipment under a procurement referred to as the communications replacement system.

We found that the new front-end processors selected by IRS have a history of being highly reliable and should be able to process IRS short-term workload requirements. However, we were not certain about their ability to meet IRS longer term needs, primarily because IRS projections of future workload, used by the contractor for sizing the processors, were outdated and could not be relied upon. We recommended that the IRS reassess its future data processing workloads to ensure that its computer resources can meet its future needs.

We also reported to you that the contractor responsible for installing the new front-end processors was experiencing problems and significant delays in making them work properly with the mainframe computers and terminals. Because of these problems and because IRS had planned originally to install the new front-end processors during the 1987 filing season, our report emphasized that IRS must thoroughly test the processors and supporting soft-

ware before installing them in the service centers. If it does not do so, it could very likely experience significant disruptions to the 1987 filing season.

Although we and IRS believed that the existing front-end processors should be able to meet the agency's needs until their planned replacement in 1987, we cautioned that a significant delay in replacing them or a significant increase in workload would increase the chances that they would not perform satisfactorily.

Accordingly, we recommended that formal contingency plans be established at each IRS service center to provide adequate backup support for the existing outdated, capacity-limited processors. We were and still are concerned that the longer IRS must depend upon these processors, the greater the chances it will experience disruptive reliability or capacity problems. IRS agreed with the need to better define its workload, to thoroughly test the new system, and to develop contingency plans.

Chairman PICKLE. How much time do you think they need to get them on line? Do you think they will have them in this season or next season?

Mr. WATTS. I think they need to get them on line as soon as they possibly can. The processors, however, must be thoroughly tested before they put them on line. Our caution is the old processors that are there are having some reliability problems.

In 1986, as I will get into a little later, IRS did handle the problems on a reasonable basis and it did not have significant problems with the processors.

The important thing is the need to pay continued attention to those front-end processors to make sure they don't breakdown for extended periods of time?

Chairman PICKLE. All right.

Mr. WATTS. After we provided you with our report some significant events occurred that increased the importance and significance of our conclusions and recommendations dealing with the testing and the installation of the new front-end processors.

In November 1986, shortly after our report was issued, the system developed by the contractor failed an acceptance test. Specifically, the system could not process the volume of transactions called for under the test. While we have not independently assessed the causes of the systems' failure, IRS told us that it has found serious problems with both some of the software and the hardware needed for the new system.

Within the last few weeks IRS told us progress has been made toward solving the hardware problem and that it has agreed with the prime contractor that a major redesign of the software is necessary. This redesign is estimated to further delay acceptance testing until June 1987. As a result, IRS does not expect to have the new processors installed in all service centers until September 1988 or about 1 year after the original scheduled date.

Consequently, all service centers will have to rely upon the existing processors for the current filing season and all but two will have to rely on them during the 1988 season.

We believe this delay reinforces the need for IRS to have formal, workable contingency plans specifying actions IRS will take in the event that the existing processors and terminals experience ex-

tended periods of downtime or are unable to reasonably handle their workloads prior to replacement. We recently reviewed IRS initial efforts to develop formal contingency plans at each service center and believe that more needs to be done to ensure a reasonable and swift continuity of data processing support. IRS agrees and is currently in the process of developing a more thorough contingency plan.

The delay in replacing the old processors also has both productivity and cost implications for IRS operations. For example, the existing processors prevent IRS from expanding the number of computer terminals at its larger service centers, which already have the maximum number of terminals connected to the old system. IRS has determined that it needs the additional terminals to improve the efficiency and productivity of critical IRS functions such as returns processing, taxpayer services, collections, and examinations.

Also, computer terminal maintenance costs are likely to increase as a result of the delay. The front-end processor procurement includes the replacement of about 4,100 old computer terminals installed in the early 1970's. The cost to maintain these old terminals is higher than the cost to maintain the new ones. These increased costs could range up to $1 million a month. However, IRS is attempting to mitigate these costs by replacing the most costly terminals to maintain before the new processors are installed.

Now, I would like to turn to the mainframe computers which I described to you earlier. In that study, we focused on the capacity of the mainframes to process IRS' workload. We concluded, as did IRS, that it did not need to spend $186 million to upgrade or replace these computers by 1989 as originally planned.

According to our analysis they have sufficient capacity to handle IRS needs to mid-1991. This was only 6 months short of when the tax system redesign project would have provided new computers and redesigned software. While our analysis shows that the current mainframes could last until mid-1991, it also showed that to last that long IRS must carry out several planned initiatives to make more efficient use of the mainframes. Otherwise, capacity could run out as early as mid-1988 after all.

These initiatives include, among other things, realigning the workloads among the service centers, further improving the efficiency of computer software, and constraining workload growth to a rate of 8 to 10 percent per year.

We believe this latter initiative of constraining workload growth to 8 to 10 percent is the most critical to extending the useful life of the mainframes. However, it is probably the most difficult to achieve. For example, as I have just discussed, IRS plans to install the new greater capacity front-end processors and it plans to expand the terminal network. Furthermore, the Tax Reform Act and other planned applications may also affect IRS ability to constrain growth. All these factors have the potential to generate a larger workload.

To accomplish this we recommended that IRS, one, develop and maintain comprehensive workload data for current and planned requirements; two, monitor the performance of the currently installed systems; and three, analyze the impact of the various workloads on the installed systems. IRS agreed.

Here again, recent events serve to underscore the importance of our recommendations to IRS. We have been told by IRS officials that the chances for on-time delivery of IRS' planned tax system redesign project beginning in 1992 are now remote because of recent changes in IRS strategy for this project. Because of these changes, the implementation of this project could slip to 1993–94, thus creating at least a 2½ year gap between our projection of the useful life of the current mainframes and the availability of the new system.

Nonetheless, IRS officials believe that planned efficiency improvement initiatives can extend the mainframe computers through 1993. However, in our opinion IRS has not done the necessary analysis to support this position.

The uncertainty over the expected useful life of the mainframes reinforces the need for IRS to better define its workload needs, and in particular, monitor the performance of the mainframes. We believe that without this workload analysis, as well as a continuing analysis of current system utilization, IRS will not have adequate information to determine whether its initiatives are working and could find itself short of computer capacity earlier than planned and without enough warning to take timely corrective action.

After we issued our report in November 1986, IRS has taken some initial steps to implement our recommendations. IRS told us that it plans to begin full monitoring of computer performance by June 30, 1987. In addition, IRS also plans to convene an executive task force that will oversee the implementation of all but one of the initiatives. The task force is charged with developing a plan by March 31, 1987, a plan that will identify, one, the actions necessary to accomplish the initiatives, two, the organizations responsible for implementing them, and three, target dates for completing them.

The one initiative the task force will not oversee is the realignment of workloads among the service centers. IRS has decided to defer this initiative until 1989 and 1990; IRS feels it needs to devote itself to implementing the Tax Reform Act in 1988.

You also asked us to comment on the tax system redesign. Although we have not evaluated it, we can provide you with information on its objectives and status.

In August 1982, a project office was established to redesign the tax processing system for the 1990's and beyond. Management attention for the project was elevated in October 1984 when IRS established an Assistant Commissioner for Tax System Redesign.

Since that time, two IRS executives have been named to that position with the first serving for only 6 months and the other assuming the office just this past November. On January 15, 1987, IRS extended the responsibilities of this office and designated it the focal point for introducing new technology and for ensuring compatibility among existing and future systems.

While the strategy for accomplishing system redesign has been fluid, the objectives have generally remained the same: namely, one, to introduce state-of-the-art computer and telecommunications technology; two, to provide faster access to all taxpayer information; three, to better link related information on taxpayers, and, four, to automate manual and paper-intensive processes. To accom-

plish these objectives, IRS envisions tax system redesign as an evolutionary process.

The IRS is taking the first step of this evolutionary process by developing a preliminary design concept, an acquisition strategy, a transition plan, and a management plan. These products are planned for completion in February 1988.

Because of the importance of this effort we will be reviewing the progress of the project and reporting to you and the IRS on matters that we feel need your attention.

Finally, Mr. Chairman, you asked us to discuss how well IRS computers have supported the 1987 filing season. During the first month, the existing front-end processors and mainframe computers have experienced short periods of downtime, but these instances have not significantly affected IRS operations.

In addition, the service centers have also been completing their weekend processing on time, which had been a major problem during the 1985 tax filing season. Nevertheless, this filing season has just begun and IRS has yet to receive and process the vast majority of tax returns.

In summary, Mr. Chairman, IRS management has a major challenge facing it because a number of critical events related to IRS computer resources will be occurring over the next few years.

These include continuing to use aging front-end processors, introducing new terminals and front-end processors, changing computer software to accommodate tax reform, extending the useful life of the mainframes, further automating other IRS functions, and planning and redesigning the tax system redesign project.

These events will require continued management attention by IRS to make sure they are carried out effectively while also insuring that computer resources adequately support the collection of taxes and properly serve the taxpaying public.

This concludes my prepared statement. We will be pleased to answer and respond to any questions.

[The statement of Mr. Watts follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE

Washington, D.C. 20548

For Release
Expected at 10:00 a.m
Friday, February 6, 1987

Statement of
James R. Watts, Associate Director
Information Management and Technology Division

Before the
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Computer Support for Tax Processing Needs Continuing IRS Attention

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to provide information on the Internal Revenue Service's (IRS') computer systems. These systems are critical to processing tax returns, answering taxpayer inquiries, and issuing refunds. The computer issues we will discuss are the focus of two recent GAO reports to this Subcommittee.[1] In these reports we made recommendations to IRS that we believe are essential to ensuring that computer resources adequately support the successful processing of tax returns in this filing season and in the future. I will briefly summarize these reports and, on the basis of some limited follow-up work, provide you with the current status of these issues and IRS' actions on our recommendations. I will also discuss how well IRS' computers have supported tax return processing during the first month of the 1987 filing season and comment on the objectives and status of the Tax System Redesign project.

IRS is highly dependent on computers to support its mission. The proper management of these resources is crucial for the timely processing of about 180 million tax returns annually and for ensuring that the nation's tax laws are administered efficiently and effectively.

The first critical component of the tax processing system that we want to discuss is the front-end processor. IRS employees require access to information on the large mainframe

[1]Details of the issues discussed in this testimony can be found in the following two reports entitled DATA COMMUNICATIONS: Thorough Testing and Workload Analyses Needed For IRS Processors (GAO-IMTEC-87-3BR), October 14, 1986, and COMPUTER CAPACITY: IRS Must Better Estimate Its Computer Resource Needs (GAO-IMTEC-87-5BR), November 3, 1986.

computers to correct errors in tax returns and to answer taxpayer inquiries. They gain this access by using terminals which connect to the front-end processors. IRS' current front-end processors and some of the computer terminals are old and susceptible to reliability and capacity problems. To correct these problems, in February 1986, IRS awarded a contract for about $150 million to replace this equipment under a procurement referred to as the Communications Replacement System. (See Exhibit 1 for a chronology of events associated with the contract.)

We found that the new front-end processors selected by IRS have a history of being highly reliable and should be able to process IRS' short-term workload requirements. However, we were not certain about their ability to meet IRS' longer-term needs, primarily because IRS' projections of future workload, used by the contractor for sizing the processors, were outdated and could not be relied upon. We recommended that IRS reassess its future data processing workloads to ensure that its computer resources can fulfill its mission.

We also reported to you that the contractor responsible for installing the new front-end processors was experiencing problems and significant delays in making them work properly with the mainframe computers and terminals. Because of these problems and because IRS had planned originally to install the new front-end processors during the 1987 filing season, our report emphasized that IRS must thoroughly test the processors and supporting software before installing them in the service centers. If it does not do so, it could very likely experience significant disruptions to the 1987 filing season.

Although we and IRS believed that the existing front-end processors should be able to meet the agency's needs until their planned replacement in 1987, we cautioned that a significant delay in replacing them or a significant increase in workload would increase the chances that they would not perform satisfactorily. Accordingly, we recommended that formal contingency plans be established at each IRS service center to provide adequate backup support for the existing outdated, capacity-limited processors. We were and still are concerned that the longer IRS must depend upon these processors the greater the chances it will experience disruptive reliability or capacity problems. IRS agreed with the need to better define its workload, to thoroughly test the new system, and to develop contingency plans.

After we provided you with our report, some significant events have occurred that increase the importance and significance of our conclusions and recommendations dealing with the testing and installation of the new front-end processors. In November 1986, shortly after our report was issued, IRS found that the system developed by its contractor failed an acceptance test. Specifically, the system could not process the volume of transactions called for under the test. While we have not independently assessed the causes of the system's failure, IRS told us that it has found serious problems with some of the hardware and software needed for the new system.

Within the last few weeks IRS told us progress has been made toward solving the hardware problem and that it has agreed with the prime contractor that a major redesign of the software is necessary. This redesign is estimated to further delay

acceptance testing of the system at IRS until June 1987. As a result, IRS does not expect to have the new processors installed in all service centers until September 1988 or about one year after the original scheduled date. (See Exhibit 2 for information on slippage in the installation schedule.) Consequently, all service centers will have to rely upon the existing processors for the current filing season and all but two will also have to rely on them during the 1988 season.

We believe this delay reinforces the need for IRS to have formal, workable contingency plans specifying actions IRS will take in the event that the existing processors and terminals experience extended periods of downtime or are unable to reasonably handle their workloads prior to replacement. We recently reviewed IRS' initial efforts to develop formal contingency plans at each service center and believe that more needs to be done to ensure a reasonable and swift continuity of data processing support. IRS agrees and is currently in the process of developing a more thorough contingency plan.

The delay in replacing the existing processors also has both productivity and cost implications for IRS' operations. For example, the existing processors prevent IRS from expanding the number of computer terminals at its larger service centers, which already have the maximum number of terminals connected to the old system. IRS has determined that it needs the additional terminals to improve the efficiency and productivity of critical IRS functions such as returns processing, taxpayer services, collections, examinations, and criminal investigations.

Computer terminal maintenance costs are also likely to increase as a result of the delay. The front-end processor procurement includes the replacement of about 4,100 old computer terminals installed in the early 1970s. The cost to maintain these old terminals is higher than the cost to maintain the new ones. These increased costs could range up to $1 million dollars a month. However, IRS is attempting to mitigate these costs by replacing the most costly terminals to maintain before the new processors are installed.

Now, I would like to turn to the mainframe computers. The large mainframe computers at the agency's 10 service centers are the backbone of the tax processing system. These computers are used, among other things, to (1) check tax returns for mathematical accuracy and completeness, (2) generate notices to taxpayers informing them of errors or requesting additional information, and (3) maintain information to resolve collection and examination cases and to respond to taxpayer inquiries.

Between March and June 1986 we reviewed the capacity of IRS' mainframe computers and concluded, as did IRS, that it did not need to spend $186 million for a planned upgrade or replacement of these computers by 1989. According to our analysis, they have sufficient capacity to handle IRS' needs to mid-1991. This was 6 months short of when the planned Tax System Redesign would provide new computers and redesigned software. While our analysis showed that the current mainframes could last until mid-1991, it also showed that IRS must carry out several planned efficiency improvement initiatives to extend their useful lives. Otherwise, capacity could run out as early as mid-1988. These initiatives include: realigning workloads among service centers; constraining workload growth to a rate of 8-10 percent per year; and further improving the efficiency of computer software programs.

We believed the initiative which calls for constraining IRS' workload growth to 8-10 percent is the most critical to maintaining the useful life of the mainframes but also the most difficult to achieve for several reasons. For example, IRS plans to install new faster front-end processors and it plans to expand the terminal network. Furthermore, the Tax Reform Act and other planned applications may also affect IRS' ability to constrain growth. All these factors have the potential to generate a larger workload.

On the basis of our analysis, we concluded that it was essential for IRS to make a more reliable prediction of its computer needs and make more efficient use of the existing mainframes. To accomplish this we recommended that IRS (1) develop and maintain comprehensive workload data for current and planned requirements; (2) monitor the performance of the currently installed systems; and (3) analyze the impact of the various workloads on the installed systems. We believed then and still do, that such action would improve IRS' management of its computer resources as well as its planning for future computer resource needs. IRS agreed with our findings, conclusions, and recommendations.

Recent events serve to underscore the importance of our recommendations to IRS. We have been told by IRS officials that the chances for on-time delivery of IRS' planned Tax System Redesign project beginning in 1992 are now remote because of recent changes in IRS' strategy for this project. Because of these changes, the implementation of this project could slip to 1993/1994, thus creating at least a 2 1/2 year gap between our projection of the useful life of the current mainframes and the availability of the new system. Nonetheless, IRS officials believe that planned efficiency improvement initiatives can extend the useful life of the current mainframe computers through 1993. However, in our opinion IRS has not done the necessary analysis to support this position.

The uncertainty over the expected useful life of the mainframes reinforces the need for IRS to better define its workload needs, and in particular, monitor the performance of the mainframes. We believe that without this workload analysis, as well as a continuing analysis of current system utilization, IRS will not have adequate information to determine whether its initiatives are working and could find itself short of computer capacity earlier than planned and without enough warning to take corrective action.

After we issued our report in November 1986, IRS has taken some initial steps to implement our recommendations. IRS told us that it plans to begin full monitoring of computer performance by June 30, 1987. In addition, IRS also plans to convene an executive task force that will oversee the implementation of all but one of the initiatives. The task force is charged with developing a plan by March 31, 1987, that will identify 1) the actions necessary to accomplish the initiatives, 2) the organizations responsible for implementing them, and 3) target dates for completing them. However, the executive task force has yet to convene.

The one initiative the task force will not oversee is the realignment of workloads among the service centers. IRS has decided to defer this initiative until 1989 and 1990; the agency

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believes that it needs to devote its full attention in 1988 to implementing the Tax Reform Act.

You also asked us to comment on the Tax System Redesign. Although we have not evaluated it, we can provide you with information on its objectives and status.

In August 1982, a project office was established to redesign the tax processing system for the 1990s and beyond. Management attention for the project was elevated in October 1984 when IRS established an Assistant Commissioner for Tax System Redesign. Since that time two IRS executives have been named to that position with the first serving for only 6 months and the other assuming the office just this past November. On January 15, 1987, IRS extended the responsibilities of this office and designated it the focal point for introducing new technology and for ensuring compatibility among existing and future systems.

While the strategy for accomplishing system redesign has been fluid, the objectives have generally remained the same: (1) to introduce state-of-the-art computer and telecommunications technology; (2) to provide faster access to all taxpayer information; (3) to better link related information on taxpayers; and (4) to automate manual and paper-intensive processes. To accomplish these objectives, IRS envisions Tax System Redesign as an evolutionary process. We understand that a key element of this approach will be the development of IRS-wide databases that will include all the commonly used information for tax administration throughout IRS. The service is taking the first step of this evolutionary process by developing a preliminary design concept, an acquisition strategy, a transition plan, and a management plan. These products are planned for completion in February 1988.

Because of the importance of this effort we will be reviewing the progress of the project and reporting to you and IRS on matters that we feel need your attention.

Finally, Mr. Chairman, you asked us to discuss how well IRS' computers have supported tax return processing during the 1987 filing season. During the first month, the existing front-end processors and mainframe computers have experienced short periods of downtime and the service centers have encountered some operational problems, but these instances have not significantly affected IRS' operations. In addition, the service centers have also been completing their weekend processing on time, which had been a major problem during the 1985 tax filing season. Nevertheless, this filing season has just begun and IRS has yet to receive and process the vast majority of tax returns.

This concludes my prepared statement. We will be pleased to respond to any questions.

EXHIBIT1

COMMUNICATIONS REPLACEMENT SYSTEM CHRONOLOGY OF EVENTS

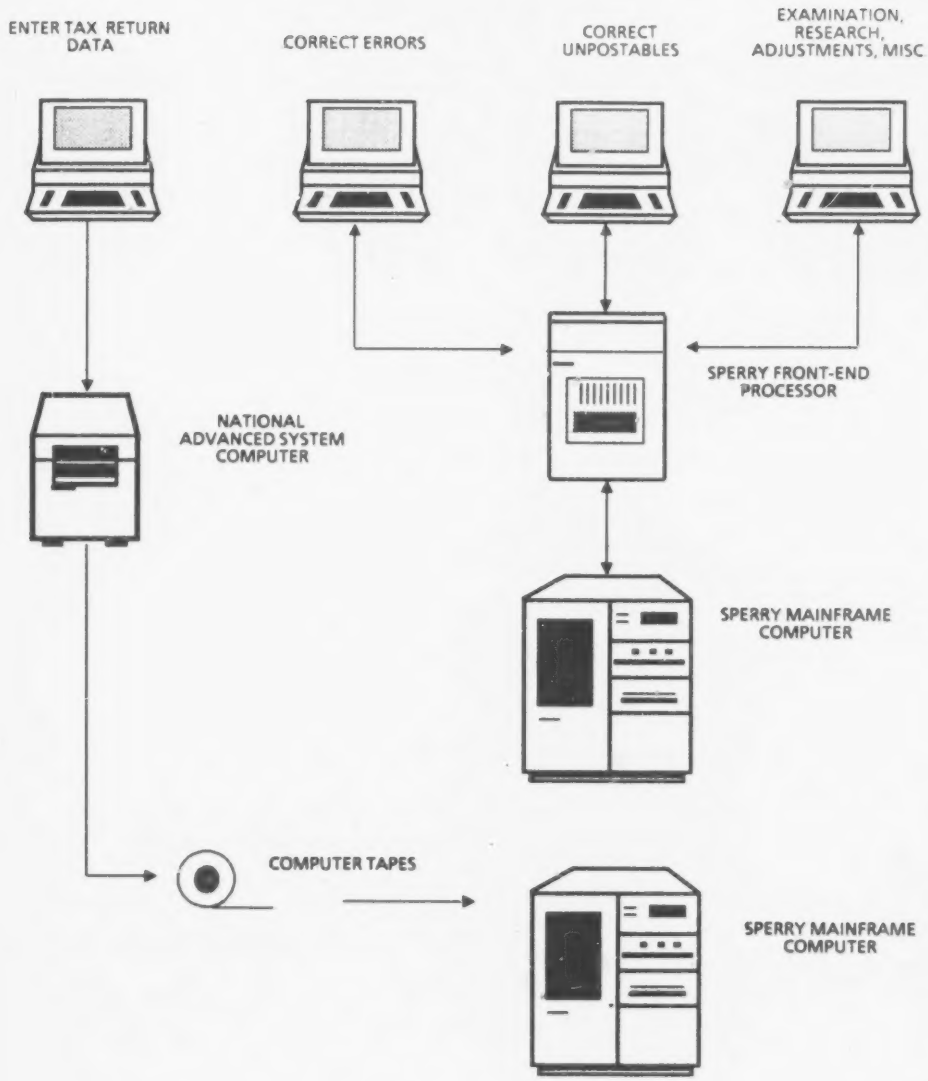
Nov. '82	IRS' feasibility study concludes upgraded equipment needed
Dec . '83	IRS distributes draft Request For Proposal (RFP) for industry review
Aug. '84	IRS issues Request For Proposal
Oct. '85	IRS awards contract to Computer Systems and Resources, Inc. (CS&R)
Jan. '86	Because CS&R does not meet the technical requirements in the RFP the General Services Administration's Board of Contract Appeals orders IRS to terminate CS&R contract and to either recompete or award contract to Sysorex Information Systems, Inc. (Sysorex)
Feb. '86	IRS awards contract to Sysorex
July '86	Sysorex is unable to begin system testing at IRS' National Computer Centers; IRS institutes $5,000 per day liquidated damages penalty
Oct/Nov '86	System testing conducted at the IRS National Computer Center; system fails test
Nov. '86	IRS notifies Sysorex that the contract may be terminated for default and requests a cure to the deficiencies
Dec. '86	Sysorex responds to the IRS, requesting 6 months to redesign software (and correct other system deficiencies)
Jan. '87	IRS accepts the Sysorex cure and revises its installation schedule allowing Sysorex to redesign the system's software by June 1987 and to install new terminals beginning in March 1987

EXHIBIT 2

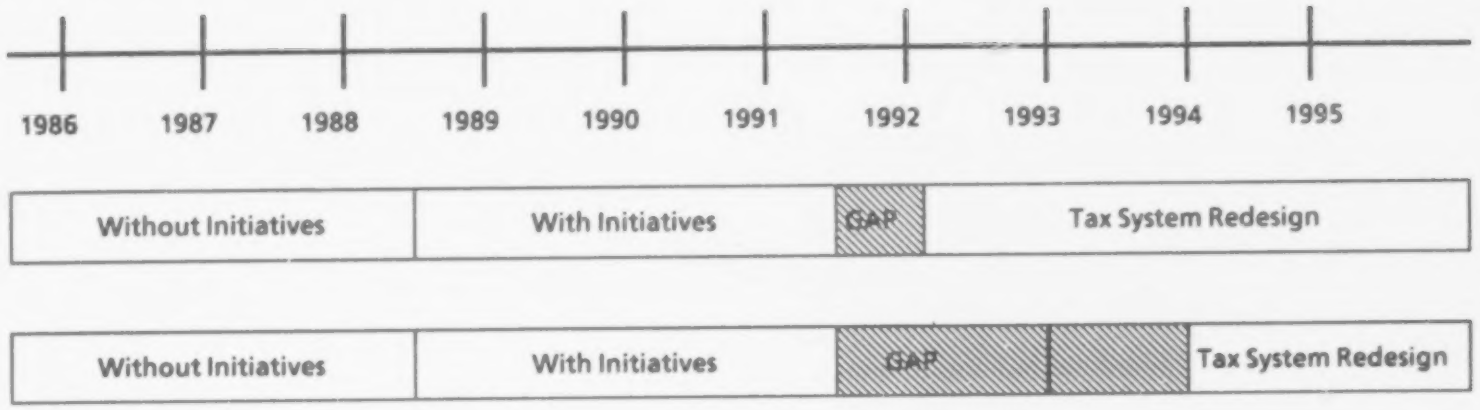
COMMUNICATIONS REPLACEMENT SYSTEM
INSTALLATION SCHEDULE

ACTION	MILESTONES AS OF JUNE 27, 1986	MILESTONES AS OF FEBRUARY 6, 1987	SLIPPAGE IN MONTHS
Install Hardware at National Computer Center (NCC)	07/01/86	07/01/86	----
Conduct NCC system acceptance tests	07/24/86	06/15/87	11
Conduct systems acceptance tests at first service center	11/03/86	09/15/87	10
Completion date for installation at all service centers	10/09/87	09/28/88	12

IRS SERVICE CENTER TAX PROCESSING SYSTEM OVERVIEW



IRS Mainframe Computer Capacity



Chairman PICKLE. I want to thank you, Mr. Watts. I think we ought to make a change in the formal question and answer period here and ask Mr. Gibbs to come up to the witness table if you would, Mr. Commissioner.

I am concerned about the aspect of the planned tax system redesign project. Mr. Watts, on page 8, you state that the IRS officials have said the chances for on-time delivery of the IRS tax redesign project, to begin in 1992, is now remote because of a recent change in IRS strategy for this project.

Because of this change implementation of this project would slip to 1993, and 1994, thus creating at least a 2½ year gap between our projection for the useful life of the current mainframes and the availability of the new system.

Mr. Commissioner, is that statement your people have made? Are you in agreement with that? What response do you have to that observation?

Mr. GIBBS. The statement that we have made, Mr. Chairman, I think has been accurately summarized in the sense that we do believe that we are looking, from the standpoint of our tax system redesign, we are looking at 1993 to 1994 availability.

Let me explain why. This is probably one of the most important things that will impact our tax system and what we want to be sure of, given the problems in 1985, is that in the rush to address capacity problems that we don't make the error of designing a system that simply is not going to work for its intended purposes.

And for that reason, we want to be sure that before we put tax system redesign into effect, that we have the necessary time to develop it and it's going to be developed through stages as has been summarized here.

I think it is fair to say this again was another project that was in existence when I came on board in August. I have the new Assistant Commissioner for Tax System Redesign to my left, Mr. Hank Philcox.

I am pleased and satisfied with the work that he is doing and with the time frames that he is setting. I believe that under his guidance we will have something to present to you as we go along this year, and by this time next year I believe you will see that for the first time really we will have something to show you concretely on tax system redesign.

But to answer your specific question, yes, we are talking about a 1993–94 timeframe to bring it on line.

Chairman PICKLE. You are admitting then that we might have a 2½ year gap between the projected of the useful life of the current mainframe and the availability of the new system, is that correct?

Mr. GIBBS. Mr. Chairman, I am not sure that is correct. Let me address that.

We agree that from the standpoint of the capacity of our existing system, at the present time, we understand those projections and we agree that we could have problems by 1991.

I am not sure we are in disagreement with GAO on this. What we are saying is that we think among the things that we have already identified and that we need to work on, there are alternatives to give us additional capacity for a longer period of time. What I understand GAO to say to us is this, they say you may be

right but you have not convinced us. You need to do more work on that to convince us that you can.

Chairman PICKLE. The GAO did say that you ought to better define your workload needs, in particular by monitoring the performance of the mainframes.

Are you doing that? Do you agree with that?

Mr. GIBBS. We do agree with that and let me turn to Hank Philcox. I think we are doing that.

Mr. PHILCOX. Mr. Chairman, we currently do have that underway. We are developing a sophisticated computer modeling process to give us better and more reliable forecasting information. That is evolving right now. We are satisfied that as a result of that we will be able to much more accurately predict what the impact of events will be on that mainframe system.

Chairman PICKLE. GAO, do you have any response to that?

Mr. WATTS. I think that they are trying to put themselves in the right position to take care of the problem. As you rightly pointed out, we are concerned that they do the kind of analysis that can, in fact, forecast better when they will run out of capacity.

The size of the gap is very critical. IRS must be in a position of knowing when it is going to run out of capacity, and when tax system redesign is going to come on board. If that gap turns out to be a very short period of time, then IRS has a certain set of alternatives that it can consider to tide it over.

On the other hand, if the gap looks like it is going to be very large, IRS may have to consider a different set of alternatives to solve the problem.

In summary, we are saying that IRS needs to put in place those management controls, if you will, and make the necessary analysis so it can make a better prediction of what that gap is going to be. This will make it possible for IRS to select the proper alternative so that it won't run out of capacity to process tax returns and administer the tax laws.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Watts, I am sure you are familiar in the military with what they call a SLEP, service life extension program, whereby they will take existing equipment, modernize it a little bit and get additional usage.

Is that what you are saying should be done here, sort of an extension program for making sure that this gap does not exist if and when the time comes? Is that feasible to do so?

Mr. WATTS. Yes. There are a number of initiatives that the Service is working on to accomplish those kinds of things. Some of them are adding, if you will, more computer power to the existing mainframes; however, there are limits to the amount of computer power you can add before you have to replace the mainframes.

Mr. SCHULZE. Can that be done with just an additional piece of equipment or is that something you do in the existing equipment?

Mr. WATTS. It is done primarily by adding to the existing equipment. Now, they are also trying to optimize their software so that it will not require lengthy amounts of time to run on the mainframes. When you put code together to develop software, it tends to

be very labor intensive and, as a result, the software can contain very inefficient code.

However, you can go back and optimize that code and considerably shorten the time needed to run the software on the mainframes; this will free up processing capacity. They are doing that and have plans to do more.

Mr. SCHULZE. Is it time or quantity of data that is the key or both?

Mr. WATTS. To determine capacity?

Mr. SCHULZE. Yes.

Mr. WATTS. It is really both. The amount of data that you put on these systems is going to dictate a certain computer requirement. Time is also important, particularly at IRS where you have such large numbers of terminals; when capacity begins to be a problem, then the response time at those terminals slows down.

You may have encountered similar situations, such as standing in line in a bank or a store waiting a long time to be served. If an IRS employee has to start waiting 1, 2, or 3 minutes at a terminal to get a response from the mainframe, it becomes frustrating and cuts down on productivity. So quantity of data and time are very important.

Mr. SCHULZE. Going back, if I may, Mr. Chairman, to the communications replacement system.

Mr. WATTS. Yes, sir.

Mr. SCHULZE. It seems to me that the 12-month slippage is not too bad. Am I right or wrong? It sounds like a long time, but 12-month slippage seems to be something that we ought to be able to live with.

Do you agree with that or is this worse than I view it?

Mr. WATTS. IRS is not the only one to have slippage. We should understand that up front. The question is, I think, that they really have to watch what happens to the existing front-end processors. Our position basically is, don't put those new ones in just to put them in. Make sure that everything works because if it doesn't, IRS could have a bigger problem than it has today. Recognizing that IRS must wait until the new ones work properly, it really needs to keep on top of the old front-end processors it has today.

It is not a simple black and white answer. You have to look at both sides of the issue.

Mr. SCHULZE. In replacement of the computer terminals are they integrated so that as they are replaced they will work with both the old and the new systems?

Mr. WATTS. Yes. That is what they are doing. The old Control Data terminals that they now have, as I mentioned, are very old and very costly to maintain. What they are doing is replacing some of the old terminals with new IBM computer terminals that they are buying under this contract.

Because of differences between the two types of terminals, IRS has to make some modifications to allow the new terminals to work with the existing front ends. When the new front ends are eventually installed, then it is a relatively easy process to switch the new IBM terminals over so they will work with the new front ends.

Mr. SCHULZE. So that can go forward. That is good news.

Mr. WATTS. Yes.

Mr. SCHULZE. You are to be congratulated on that.

Mr. WATTS. And it is to their credit that they are doing that. That is a very, very costly operation they have.

Mr. SCHULZE. That is enough for now, Mr. Chairman.

Thank you.

Chairman PICKLE. We have been told, Commissioner Gibbs, that you hope the contractor for the front-end processors will be able to move forward and test by September.

Mr. GIBBS. Yes.

Chairman PICKLE. Now, I ask you, as a person who has reviewed these processors, can the contract meet the revised schedule for replacing the front end processors by September?

Mr. WATTS. As I pointed out in my statement, we have not looked at the proposal that the prime contractor has made, so I really can't comment on whether that will work or not.

Chairman PICKLE. Can you tell me what was the main reason for the delay in the front-end processors?

Mr. WATTS. Yes.

Chairman PICKLE. The testing?

Mr. WATTS. It is good to start back in time, I think. The important date was July 24 when the contractor was required to run, if you will, an acceptance, to prove that the entire system will work, recognizing there is hardware and software being provided by up to four different vendors here.

That test was deferred essentially to October.

Chairman PICKLE. If the IRS had not made mistakes in its original acceptance of this CS&R proposal could the delays have been avoided? Mr. Gibbs may say they didn't make a mistake. Could they have been avoided, Mr. Gibbs? I am talking about the main reason for the delay in the front-end processors. I have been advised that IRS had made some mistakes, that is, in the original acceptance of this CS&R thing. Is that correct or not?

Mr. GIBBS. Mr. Chairman, I honestly believe that from the review that I have made, the reason that the system did not come in on time from the standpoint of it passing the acceptance test in July, was because of the fact that the folks under this contract, the one we signed in February of last year, didn't do what they were supposed to do and I don't see——

Chairman PICKLE. How about the subcontracts?

Mr. GIBBS. Frankly, I don't know. When I sat down and met with the principals of the contract and the subcontract I couldn't tell—it was a bunch of finger-pointing in terms of who was at fault.

Chairman PICKLE. Is that still the situation?

Mr. GIBBS. Frankly, no. With respect to the original reason, I have not gotten into trying to solve that. I am much more interested in getting that the front-end processors on line as quickly as possible.

Chairman PICKLE. And I know you've got a sticky, even legal problem down there, but it ought to be unraveled as quickly as possible. I want to ask one followup question, Mr. Gibbs. When you are talking about the redesign system schedule, would it be safe to do it by 1992? Are you just talking about more computer capacity or are you also considering reducing the service that you provide taxpayers?

Mr. GIBBS. Thank you, Mr. Chairman, for that question.

It seems to me I am becoming computer literate in this position.

Chairman PICKLE. You are becoming what?

Mr. GIBBS. Computer literate, as a Commissioner. I did not have a substantial computer background, but let me see if I can try to tell you what my analysis is of the current system and what we are trying to change to.

The way I have described our current system, that began back in the 1960's and is dependent upon tape, is that what we have done over the years is we have taken a Model T Ford and souped up the engine periodically, and we have got a real high-powered engine in the Model T Ford at the present time. But it is still a Model T Ford. We are still operating on tape, and it has certain inherent limitations that in effect preclude us from getting the kind of service we want to give to taxpayers.

What tax system redesign is intended to do, Mr. Chairman, is to replace the Model T system, not just add a new engine. We want to come at it with a state-of-the-art approach that is not dependent on tape and that will tie all of our subsidiary systems—AES, ACS, ICS, all of that—together and make it an integrated whole, so that we can give better service to the taxpayers.

Chairman PICKLE. Well, are you saying then that as you need more capacity in the computers, you are not able to do it fast enough and therefore you may well slow down the taxpayer services? So that the Model T can catch up?

Mr. GIBBS. Mr. Chairman, I am saying this, simply adding more capacity to the Model T is not the answer. We can put in another engine, we can put in an even more souped up engine to give us more capacity, but the point is that the whole system that we have is tape-dependent. What it is today is not designed to give the service that tax system redesign will be designed to give. It will not only give additional capacity, but it will also integrate and bring together all of the subsystems and will give us the capacity to get information quicker. It will be better information, and we can get it to the taxpayers in a way that we are not able to do and won't be able to do with the present system.

Chairman PICKLE. I recognize you've got a serious problem. I do know that you've got serious problems in the area of the front-end processors and now you've got a weakness with respect to the mainframes, so, when you get that new capacity, can you catch up in the other areas? Or will you have to slow down, reducing taxpayer services and tax collections. That cannot be accepted, of course. I am glad you recognize that and that you are going to try to do something about it.

If I had my way one of the best things to do would be to increase the number of services for taxpayers. It seems to me you could present a helpful attitude towards the public by increasing taxpayer services. You said in your testimony this morning that you are geared up for handling more services. You have a lot of the automated phones, 3 million of them. I got a feeling that doesn't satisfy a lot of people. They got a problem and call IRS to ask a question and an automated voice comes on and makes a statement.

That gives some information but it doesn't give him the personal relationship of a taxpayer representative.

I don't say you cannot have the automated because you've got to go forward with it, you've already got it. But if you are talking about new capacity you have to slow down, meet yourself coming and going. How we bridge those two I guess is our problem.

Mr. GIBBS. And that is why I think it is so critical to get the time, however we get it. Because we can, if we need additional capacity, we can go out and buy additional machinery. But before we do that given the cost and energy that will go into that, and recognizing the importance of what I described with tax system redesign, what we are asking for is a year to basically try to see what the alternatives are, to see if we can get some additional capacity out of what we have now to reduce the gap, and we——

Chairman PICKLE. We need more capacity, more personnel.

Mr. Commissioner, you have made a request for supplemental appropriations now of $200 million. As I understand it, about $120 million of that will go into a ranking handling for the new retirement system. The other is in, primarily in the area of the new tax reform that we passed and how to adjust to it.

What are we going to do about all the services we need for all the departments, taxpayer services in all the categories? How much does your budget allow for the 1988 budget? Have you increased personnel? I don't recall what it was.

Mr. GIBBS. Let's talk about the $150 million that you helped us get, in terms of you and Mr. Rostenkowski working with Mr. Roybal and the others. Very helpful.

Chairman PICKLE. Thank you.

Mr. GIBBS. A portion of that is going into additional taxpayer assistance personnel. A portion of the $80 million supplemental that we are talking about for fiscal year 1987 is also allocated for taxpayer service personnel and, let me check, but I believe we have additional taxpayer service personnel in our 1988 budget as well.

Now, one of the things that I discussed with Mr. Rangel when I first met him was the importance of balancing our compliance functions with our service functions. That is what we are trying to do here, Mr. Chairman, in terms of adding additional personnel into our taxpayer service area.

Chairman PICKLE. Well, we will be getting into the budget, the next year's budget, in due time. I don't want to go more deeply into it in this session, except to say that we will be anxiously anticipating what you are recommending for the 1988 budget in the area of personnel, the list of people and in what categories you want the services rendered.

Mr. Rangel, would you have questions?

Mr. RANGEL. Thank you, Mr. Chairman. Thank you, Commissioner.

Our committee has often times had the embarrassing task of restoring cuts to the IRS over the objections of the Commissioner sometimes. They say it with a wink or a blink.

Nevertheless they would say they have no problem with the budget cuts. Is it embarrassing to ask the question, are you satisfied with the budget support to your request that, whoever you make them to, from OMB?

Mr. GIBBS. Mr. Rangel, I have been pleased with the support thus far in the sense that when we asked for support from OMB on the

additional $150 million for fiscal year 1987, we got it; when we asked for a supplemental for fiscal year 1987, the administration has proposed it.

We have asked for a substantial budget increase for fiscal year 1988, and I have asked for one other thing for 1988. I have asked for the flexibility if we need it—realizing we cannot predict exactly what is going to come up as we implement tax reform—to be able to reallocate funds to service needs away from compliance needs, if we need it to assure balanced and effective tax administration, and the administration has been willing to give me that as well. That is also part of our proposal.

Mr. RANGEL. Why is it that the request for additional funds in order to improve collection effectiveness of your department always seems to come from OMB and not from the Service?

Mr. GIBBS. It starts with me, Mr. Rangel. I have to ask for it from Treasury. Then Treasury joins me and we work with OMB. Then we join with OMB to come up here for it. But it starts with me. I have to ask for it first.

Mr. RANGEL. In the budget request the President has sent to us where they pick up $6 or $7 billion based on more efficient collection, that is not OMB's, that is your request?

Mr. GIBBS. What we have basically said is this, if we are looking for additional revenue in the country, before we raise taxes on the populace, how about collecting some of the revenue that is out there where people are not paying their fair share?

Mr. RANGEL. Then you are satisfied that you have requested a sufficient amount of money to get the maximum effectiveness in the collection of taxes that are due and owing to the Government?

Mr. GIBBS. Mr. Congressman, given the stresses and strains in terms of every agency in this Federal Government asking for additional funding, given the reality of those stresses and strains, I am pleased if not satisfied with the response that we have been given. I cannot argue with the size of the total bottom line budget increase for 1988 and if I can have the authority to redirect funds as necessary, then I think realistically I have a difficult time asking for more.

Mr. RANGEL. I don't know what you are saying, but let me try it another way. If you were a private collection agency and I asked you to get the maximum amount collected that is due and owing to a particular firm, and I want to know how much money do you need in your budget to do that, can you tell me that you have done that?

Mr. GIBBS. Yes.

Mr. RANGEL. Getting more money will not increase the returns at all if you get what you are asking for?

Mr. GIBBS. In the collection area?

Mr. RANGEL. That is what I am talking about.

Mr. GIBBS. We have requested in the collection area basically the amount that we can absorb. That is basically what we have been given for fiscal year 1988—what the administration is coming forward with.

Mr. RANGEL. And you will be able to improve your ability to collect even more and if you get that you would have reached your maximum efficiency.

Mr. GIBBS. Yes, sir.

Chairman PICKLE. Would the gentleman yield on that question?

Mr. RANGEL. Yes.

Chairman PICKLE. I think in line with that, when you are talking about the request for your needs, I understand what he is saying, I would ask you to what extent are Treasury and OMB now working together to satisfy your future computer needs? Are they indicating they will give you sufficient funds to bring the computer capacity up to what you need? Are they holding back or are you having difficulty with OMB?

Mr. GIBBS. Mr. Chairman, they are asking the same sort of responsible questions that you are asking with respect to our computer projects. They are. And I don't blame them. And I don't blame you for asking those. So in terms of the questions they are asking us, they are asking those questions and they are pushing us for answers the way you are. By the same token, for the budget request that we are sending over, again given the crunch that I am talking about, they have been working with us in terms of getting the funding for the critical computer projects that we have on the drawing board and that we are working on at the present time. They have been cooperative.

Chairman PICKLE. Thank you. Mr. Rangel.

Mr. RANGEL. Your request to Treasury has not been rejected—did you get an OK on your request to Treasury?

Mr. GIBBS. With the information that has been provided to the chairman you will see that we have at times asked for more than we have been given. Yes.

Mr. RANGEL. The amount that you asked for, would that be connected in any way with your ability to collect more money?

Mr. GIBBS. At times, it has been, yes.

Mr. RANGEL. Well, I guess it is deja vu but it just seems to me if you can prove your case that you can raise more money, that you should be given as much as you can prove that you need in order to do it, but Mr. Chairman, let me congratulate you for the oversight service that you are providing to the Nation and once again the General Accounting Office has made a great contribution in allowing the Members of the Congress a better understanding of some of the problems that our Service is having.

I guess, Commissioner, that this is some indication of the willingness of the subcommittee and the committee to work with you with some of the problems that you have, even to the point of bringing this additional expertise to add to what you already have.

It is very difficult to try to be of assistance to any department that says it is happy with the cooperation they are getting from the administration but it is also even more difficult for this Member to understand how any office concerned with management and budget can deny funds to an agency whose primary job is to collect money.

I think that IRS has had a pretty good record but at some later time you are going to have to explain to me the rationale for cutting down your ability to collect money that is due and owing to the U.S. government.

Mr. GIBBS. Mr. Rangel, I would like to clarify the picture here. The Director of Finance has just told me that for 1987 and 1988, on

practically every single revenue initiative that we proposed, Treasury and OMB have supported us.

Mr. RANGEL. I am glad to hear that.

Mr. GIBBS. And I apologize.

Mr. RANGEL. We don't expect now that the Office of Management and Budget would come up with a gimmick to say there is more money out there to be collected if we do something that they request. We are dealing with the experts and you are OK with what you got?

Mr. GIBBS. Yes.

Mr. RANGEL. Thank you very much.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Rangel. Thank you.

Mr. Schulze, do you have additional questions?

Mr. SCHULZE. Just briefly, Mr. Chairman. I don't know who wants to handle this but after the tax system redesign is fully in place, how will the integration with Martinsburg and the interaction and retrieval of information be working? Can somebody tell me how that will work, what it is going to look like?

Mr. GIBBS. Congressman Schulze, let me ask again our Assistant Commissioner for Tax System Redesign, Hank Philcox, to basically discuss that with you.

Mr. SCHULZE. Sure.

Chairman PICKLE. Mr. Philcox.

Mr. PHILCOX. Thank you, Mr. Chairman.

Congressman, our planning process is just now getting under way. We have not yet gone far enough in that process to come up with a concrete physical design of how our redesigned system will look. We hope to be at that point by February of next year. At this time I can tell you that our intention is to create a real time capability in a number of geographical areas throughout the country. That is our target design.

We feel that our existing service centers will be a part of that design. We believe that Martinsburg will be a part of that overall design. But as to how the total architecture will look we have not yet gotten that far.

Mr. SCHULZE. Give me an idea on the retrieval of information.

Mr. PHILCOX. What we envision at this point in time is that the information that is currently in our master file system which is very difficult for us to retrieve, the information that we need access to will be on line and will be immediately accessible.

We will further define different levels of access for data that we need less frequently. So we will not have virtually all information on line but we will have it defined so that that needed most frequently will be available on request immediately to our field personnel.

Mr. SCHULZE. I hope I am not being too picky but it seems to me that is going to be a very important aspect of your overall service. The ability to retrieve that type of information in a rapid and efficient manner is important. But it sounds to me if that is your goal and if you can achieve it, than you are going in the right direction.

Mr. GIBBS. That is our goal.

Mr. SCHULZE. Mr. Watts, perhaps I can ask you one relatively mundane question. Would you describe for me the retrieval system as it is presently in place?

Mr. WATTS. It is cumbersome and the things you have heard from IRS are true; it is rather antiquated. The data that is officially on file is in Martinsburg. Basically, on a weekly basis, they take extracts from that file in Martinsburg and put it on computer tapes and fly those tapes out to a service center like Austin.

Mr. SCHULZE. So somebody has to physically pull the reel or the negative——

Mr. WATTS. Excuse me, the files in Martinsburg are all electronic data base files. I shouldn't use the word data base, but they are electronic files. What they do is take extractions from those electronic files, put it on a tape or several tapes, as a matter of fact, and fly them out to Austin and load them onto the mainframes that we talked about previously. Then, with those terminals they can access the information.

But this is essentially a weekly process.

[The following was subsequently received:]

INFORMATION RETRIEVAL FOR IRS

There are several sources of information available to Service employees, however, the most frequently used involves retrieval of master file data. The master file contains nationwide entity and account information. The data is stored at the National Computer Center (NCC) in Martinsburg, West Virginia. Early in the 1980's the Service implemented a system which provides overnight processing of master file requests. The requests and the responses are transmitted between the requesters (service centers and district offices) and NCC on telecommunications lines. This system provides a twenty-four hour response time. Prior to adoption of this system, processing was performed on a weekly basis. The requests were converted to microfilm and distributed to the service centers and district offices.

Mr. SCHULZE. So the tape itself is actually shipped to Austin?

Mr. WATTS. Yes, sir.

Mr. SCHULZE. That cannot be done through television, telephone wires or anything?

Mr. WATTS. It can be done with today's technology, but there would have to be significant redesigns and new equipment and things like that put in place. That is one of the fundamental objectives that they have for tax system redesign as we understand it; that is, to try to get themselves out of this very batch, difficult-to-retrieve type of situation. It is a very laudable objective and something they need to pursue, because, as the Commissioner said, it is very antiquated and it does impact on how timely they can respond to taxpayers inquiries.

Mr. SCHULZE. If you have any recommendations along that line, I would be happy to have them. I would be sure they would be passed on to IRS where you can give direction on that.

Mr. WATTS. OK.

Mr. SCHULZE. I don't want to hear you say in a few years that you have retrieval problems.

Mr. WATTS. If I could comment briefly on that for you. Tax system redesign is a very, very large effort, it is an ambitious effort, one they need to pursue and it is going to take a heck of a lot of effort to pull it off and pull it off successfully.

While we have not looked at how they will approach it per se, we know of other major efforts like this that have failed. When you look and find out why major efforts like this fail, there are two, three, four things that really go wrong. I would like to comment on maybe one or two of them.

One is what I call management commitment. The management commitment really has to come right from the top, from the Secretary, from the Commissioner. But that commitment has to be shared by every senior executive in IRS at all levels, assistant commissioners on up, regional commissioners as well. They have to understand what tax system redesign is and be totally committed to it. If they are not, there will be problems in getting it pulled off.

There is also a need at that level for exepertise and I see that expertise needed in two fundamental ways. One, is that they really have to understand how IRS does business, and obviously IRS has the executives to do that.

What IRS also needs is somebody, and these people are difficult to get, but somebody who has gone through one of these major redesign efforts and has a thorough understanding of the technology. This commitment and expertise are essential to the success of tax system redesign. There are a lot of other things that need to be put in place, but these are very, very important.

Mr. SCHULZE. Thank you.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Watts, we thank you. It seems like we do have problems in both front-end processors and the mainframes. I am going to ask that you, GAO, formally evaluate the proposal of the present contractor, whatever it is, to see whether it can be implemented and installed without further delay. Is it practical? Is it going to work? Then continue to monitor it and give us a report again in the near future just so we will know, from your standpoint, whether it is working.

Commissioner Gibbs, likewise we will be asking you to keep us abreast of the problems you are having so that we can help out and, hopefully, in turn be helpful to the taxpayer. That is the purpose of all these hearings.

I thank all you gentlemen very much.

Mr. WATTS. Thank you, sir.

Mr. GIBBS. Thank you, Mr. Chairman.

[The following was subsequently received:]

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

30 APR 1987

COMMITTEE ON
MAY 1 8 1987
WAYS AND MEANS

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
House Ways and Means Committee
1105 Longworth Building
Washington, DC 20515

Dear Mr. Chairman:

I have enclosed responses to the 14 questions related to your February 6 hearing on our 1987 operations. I appreciate the opportunity to complete the public record on this important topic.

I look forward to continuing a mutually-productive relationship with you and the Subcommittee.

With kind regards,

Sincerely,

Enclosures

1. What is the number of new employees in each of the service centers this filing season?

We are still hiring and will continue to bring people on board for peak processing into April. During that time, and throughout the season, we will also experience attrition which will require further hiring. Below is a chart which depicts the projected numbers of new employees for the three major job categories: Data Transcribers, Clerks and Tax Examiners. Typically these jobs account for about 85 percent of all new hires in the service centers and represent the most critical portion of our new hire workforce.

Major New Hire Categories

Service Centers	1987
ANSC	1430
ATSC	2327
AUSC	2194
BSC	1545
CSC	1409
FSC	1249
KCSC	1279
MSC	891
OSC	1152
PSC	1511
Total	14987

2. What are the guidelines IRS expects to use with regard to the waiver of penalties for underwithholding for tax year 1987? Please explain in detail to include discussion of how complaints of confusion with the W-4 will be treated.

By way of News Release IR-87-16, which was released March 2, 1987, the IRS announced that taxpayers will not be penalized if they are underwithheld for 1987 as long as they make a good faith effort to comply with the law and file a new withholding certificate by June 1, 1987.

Announcement 87-16 was also released on March 2, 1987, and appears in the Internal Revenue Bulletin 1987-11, dated March 16, 1987. The purpose of this announcement is to advise taxpayers of circumstances in which the IRS will waive penalties for underwithholding for tax years beginning in 1987. The IRS will waive the penalty attributable to the underwithholding of tax on wage income of any individual who files a 1987 Form W-4 or W-4A with his or her employer on or before June 1, 1987, provided

that the taxpayer has not filed the form in bad faith. This waiver will not apply to non-wage source income. The penalty may be avoided in that case if the individual can establish that the failure to meet the estimated tax requirement resulted from reliance on the 1987 Form W-4 or W-4A. Additional criteria may also be used to prevent the assertion of the estimated tax penalty, but these are, in effect, tolerances and should not be disclosed in a public document. We would be happy to brief you or the Subcommittee staff further if you would like more detail.

Copies of the news release and the announcement are included at the end of this enclosure.

3. Has the Service recovered from the 1985 filing season disaster? Are you now confident that the information in the master files for 1985 is complete and accurate?

The problems that the Service experienced during the 1985 filing season are now behind us. We have not encountered any significant problems in processing tax returns during either 1986 or 1987. This year, we are having an excellent processing season. Although receipts through March 13, 1987 are 1.7 million below last year or a decrease of 3.8 percent, we have processed 1.7 million more returns than last year for an increase of 6.2 percent. All centers have fewer returns in inventory than at the same time last year. Nationwide, our overall inventory of 13.8 million returns is 3.4 million below last year's levels.

An intensive clean up campaign was conducted by all service centers after the 1985 filing season to ensure that all tax year 1984 returns had been posted to the master file. We are confident that the master file now contains complete and accurate information.

Taxpayer Service also had a successful filing season in FY 1986. Over 54 million taxpayers were assisted by telephone, through correspondence, or in our offices. Another 1.3 million people were served by CIDS -- our centralized tax form distribution service -- and over 2 million taxpayers were helped by the Service's volunteer tax assistance, community outreach tax assistance, and other education programs.

We estimate that 85-90 percent of the people who reached us by phone in 1986 did so within two call attempts. Taxpayer Service helped individuals with a wide range of problems in 1986, from tax law questions to refund inquiries to tax account adjustments. We doubled the number of Tele-Tax

lines last year, and nearly 8 million taxpayers used them for recorded tax information and refund inquiries. In the area of taxpayer education, the Service entered into cooperative agreements with 32 non-profit organizations to conduct Tax Counseling for the Elderly programs, and 20,000 volunteers helped 965,000 taxpayers. Approximately 39,000 volunteers helped over 800,000 taxpayers through Volunteer Income Tax Assistance (VITA). Our taxpayer information efforts were extensive -- three TV tax clinics were seen by nearly 8 million viewers, and print and electronic media releases carried an estimated advertisement value of $35 million.

Is Internal Audit monitoring its recommendations of 1985?

Internal Audit monitors all audit recommendations through the Treasury Audit Recommendation Monitoring System. Seven reports were issued on the 1985 filing season that contained 62 audit recommendations. Management has completed corrective actions on 37 (60%) of the recommendations; the remaining 25 recommendations are either on schedule (13) or the original completion date has been extended (12).

Additionally, seven follow-up audits were conducted in 1986. These audits reviewed the conditions that caused the problems in 1985. The audits concluded that returns processing improved significantly from 1985 to 1986.

4. How many problems have been brought to the attention of the National Office Command Center since January 1, 1987?

The following summary covers the 1103 problems reported to the National Office Command Center (NOCC) during the period January 1 to March 15, 1987.

Total Problems Reported:	1103	
Software Related:	1080	
Hardware Related:	23	
Critical:	14	*
Non-Critical:	1089	
Currently Open:	16	
Closed:	1087	

* Critical is defined as anything that the reporter determines to be critical; i.e., whether or not the problem results in a work stoppage or serious processing slowdown.

In our hearing last year, National Office records indicated the Command Center had received 331 calls as of February 18th. This year 580 problems were reported through January 29th. What explains this tremendous increase?

The difference in the number of calls reported last year compared to 1987 is explained by three factors:

(1) The NOCC did not become operational until January 16, 1986. Comparing the two periods is somewhat misleading since the first two weeks of the year account for a large number of problems (260 of 387 non-ACS problems were reported during the first two weeks of 1987).

(2) The Command Center was new last year. Field offices underwent an initial transition period during which they became accustomed to the new problem reporting procedures. This year they are much more comfortable with the role NOCC plays and are more likely to call when they encounter difficulties.

(3) Finally, the factor most responsible for the large increase in problems reported is IRS' taking over software maintenance for the Automated Collection System (ACS). Prior to January 5, 1987, all ACS problems were handled by the vendor-operated Problem Determination Center in Chicago. The 331 problems logged through February 18 of last year included no ACS problems, whereas they accounted for 193 of the 580 reported through January 29 of this year.

How can you handle this?

We handled this is two ways. We detailed three experienced technicians and a clerk-typist to the Command Center for the months of January and February. Secondly, we required overtime of the ten permanent staff members. As noted, while the numbers indicate a substantial increase overall, the heaviest period was the first few weeks of the year. Since then, the volume has fallen noticeably. For the first two weeks of March, we have been operating with only the normal staff of ten analysts. We have had no difficulty in keeping up with the workload.

What types of critical problems have arisen? Have they been resolved and, if so, how?

Following is a brief synopsis of the fourteen critical problems and how each was resolved. The first seven involved the Service Center Replacement System (SCRS).

Three related to the same problem reported during the first week of January with the daily batch processing runs. Because of the complexity of the problem, it was not at first recognized that separate field sites were reporting the same problem. Real time processing continued during the period. A software error was corrected and a new transmittal was sent to the service centers. The problem was resolved after three days.

Two involved system "hangs" on separate occasions during weekly batch processing at the Austin Service Center (AUSC). In the first instance, a "selective recovery" was completed within one day and real time was not affected. The other problem was more severe because Austin had to rerun a large portion of the weekly batch. Integrated Data Retrieval System (IDRS) access to the affected areas was restricted between Saturday night and Tuesday morning.

One involved Individual Master File (IMF) processing. The IMF Module Balance Amount extracted to the Integrated Data Retrieval System (IDRS) did not include Net Assessed Interest. This was a complex problem because it affected all command codes and all IDRS notices using or displaying the Module Balance. The problem was reported to NOCC on a Monday morning. Senior National Office managers and technicians met that day to assess the impact and determine how best to recover. Following this planning session the National Computer Center did a re-extract of the affected accounts and shipped tapes to all service centers by early Tuesday morning. Three centers ran the update Tuesday evening but the other seven had to wait until the following weekend because of a potential impact on IDRS real time. All centers had completely recovered within six days of the problem being reported to NOCC.

One involved a new version of a command code used in the Integrated Data Retrieval System (IDRS) which had been transmitted to the field, but had been improperly linked. All service centers were given an interim fix via telephone pending a new transmittal. The problem resulted in two centers losing over an hour of IDRS real time. A new version of the command code was subsequently transmitted and successfully implemented.

The second set of seven critical problems involved the Automated Collection System (ACS):

One involved a failure in the communications control package for ACS at the Laguna Niguel Call Site. With assistance from ACS Site Support, an on-site technician re-initialized the system. Approximately one hour of real time was lost.

One occurred when the Detroit Call Site experienced a power outage caused by a fire in the same building as the Call Site. After power was restored, the system was re-initialized. Approximately two hours of real time were lost.

One was an abnormal termination during weekly batch processing at the Manhattan Call Site. Console messages indicated a corrupted data base. The site had to do a "roll forward" to restore the data base, then rerun all of the weekly runs. This recovery extended into Monday morning, causing a loss of over two hours of real time.

Three were ACS hardware outages at separate call sites. The appropriate vendors were contacted; repairs were made; and the problems resolved within one day in all three cases.

One was a system problem at the Detroit Call Site which brought real time down. The system was re-initialized and the problem quickly resolved. Subsequent analysis revealed an operator error when initializing the system.

5. What specific steps have been taken to improve quality controls at the service centers? For example, has the Service increased the amount of key verification done to insure that returns are processed accurately (done right the first time)?

For 1987, the centers were given the latitude to apply key verification at a level commensurate with the quality levels of the individual data transcribers. We have established a requirement for minimum key verification at the same quality level requirements for incentive pay.

In addition, the Program Analysis System (PAS) that identifies the type and source of errors being made was expanded to include Unpostables and Notices and Refund Review. Analysts from all centers received intensive training in the collection, analysis, and presentation of error trend data. We also established quality indicators for the major IMF programs. While these indicators will not identify a particular problem, they will inform a center early on if their quality standards for a particular program are below the quality levels established based on the results of our analysis of 1986 processing information.

An interim Individual Quality Review System was installed nationwide in March 1987. This system will increase the potential for identifying particular errors by employee by program and function. This system should identify individual training deficiencies early in the processing year. It also has the capability of early identification of procedural and systemic deficiencies.

Program changes for 1987 were fully tested prior to implementation. New training programs related to service center operations have been initiated. Additional controls have been developed to identify and correct computer problems quickly. Additional monitoring systems have been developed to identify processing problems earlier.

Have tolerance levels been increased (the level below which the Service will not math verify returns)?

Tolerances for initial Form 1040 processing have not changed since the 1986 filing season. We have not found that increased processing tolerances adversely affect either the taxpayer or revenue levels. As a result, we attempt to keep the level high enough to ensure that our processing of the notices and payments is cost beneficial; that it does not cost us more to process than the revenue we gain.

Tolerances for math verifying amended returns were last raised in August 1985. At that time, adjustments inventories were very high, and raising the tolerance level for math verification provided a means to help reduce those inventories. Since inventories have been significantly reduced, there is no need for us to raise tolerances even higher.

6. How much money is being lost due to the expiration of the statute of limitations on collection?

During fiscal year 1986, $1.1 billion was written off due to the expiration of the collection statute.

7. During Appropriations Committee hearings on the IRS budget request for fiscal year 1987, IRS projected that it would receive about 28 million telephone calls for tax assistance during the current filing period, but noted that it was staffed to handle only 22 million calls.

A. How many telephone calls for tax assistance did IRS receive during last year's filing period?

From January 4 through April 26, 1986 -- last year's filing season -- we answered approximately 19.3 million telephone calls. In addition, we answered 1.3 million calls for tax forms via our CIDS (Centralized Inventory Distribution System) program last year.

B. How many calls is IRS expecting this filing period and how many is it staffed to handle?

This year, we are expecting approximately 23.3 million toll-free telephone calls during the filing period, and Taxpayer Service is funded to answer 17.6 million of these.

C. Will IRS have to assign staff from other functions, like Examination or Collection, to handle telephone calls this year?

Yes, once again in FY 1987 we have redirected both staff and resources from Examination and Collection to Taxpayer Service to increase the number of toll-free telephone calls we can answer.

8. Besides providing assistance over the telephone, IRS also provides assistance at walk-in offices, through correspondence, and through automated systems like Tele-Tax. How has the availability of these forms of assistance changed since last year?

The availability of assistance at walk-in offices and through correspondence is similar to that provided during 1986. Also, the number of Tele-Tax sites and lines did not increase from 1986 to 1987. However, several changes were made to the Tele-Tax program to improve accessibility and provide more information to callers using the automated refund service. First, the toll-free Tele-Tax number was listed in the tax packages for the first time this year (it could not be done last year because toll-free funding was not approved until after the tax packages were printed). Also, an automated call handler was added to the equipment to increase the ability of rotary (dial) callers to get into the system. Additional refund responses were added to give more detailed information to callers when their refund was delayed, e.g., if a math error was made, and a new fact-of-filing response now tells callers if their return has been received but processing is not yet completed.

9. In the past, IRS has attempted to handle between 80 and 85 percent of the taxpayer inquiries received. Are you equipped to handle the expected increase in taxpayer inquiries generated by the Tax Reform Act of 1986?

We are funded to provide a 65 percent level of service to taxpayers who call for help in FY 1988. One option which is open to us to increase this service level is to again redirect resources from our Examination and Collection programs. We have done this for the past two years and have provided toll-free telephone service levels ranging from 75 to 81.

We will assist taxpayers who have questions on the Tax Reform Act through a variety of other means. We expect to serve 10 million callers via our Tele-Tax system and recorded tax messages in FY 1988. In addition, we intend to continue to conduct vigorous Community Outreach Tax Assistance, Volunteer Income Tax Assistance (VITA), and Tax Counseling for the Elderly (TCE) efforts. These three programs -- the last two of which are coordinated by volunteers -- helped a combined 2.1 million taxpayers in 1986; we expect even more to be assisted in 1988. Finally, we have again planned a proactive Taxpayer Information effort next year. Our TV tax clinics, TV and radio spots, and other electronic print media campaigns will provide help to many taxpayers who would otherwise call us for assistance.

10. How will the changes resulting from the Tax Reform Act of 1986 affect the formulas (TCMP) IRS uses to select returns for audit? Because those formulas were developed on the basis of audits of returns that were conducted before tax reform, won't they be less relevant to the returns prepared after tax reform? If those formulas are less precise in identifying the most productive returns to audit, won't that affect IRS' ability to maximize the revenues generated by its examination function? When will IRS have new formulas in place that reflect the impact of tax reform?

We have reformatted the latest data base available from the Taxpayer Compliance Measurement Program (TCMP) to simulate the new tax law changes and have developed new formulas. These formulas will be implemented in January 1988 for scoring 1987 tax returns. While not as precise as formulas developed from a new TCMP data base, we expect these formulas to be very effective at selecting productive returns to audit. A new TCMP effort, reflective of tax reform, will be completed for 1988 tax returns filed in 1989.

11. Since 1985, the front-end processors have been identified as the weak link in IRS's computer operations, and in need of replacement.

A. What is the primary cause for the delay in replacing the front-end processors?

There are two primary causes for the delay in replacing the front-end processors. Initially, as discussed in GAO's August 1986 report entitled, "No Improper Actions Found on IRS' Contract for Data Retrieval System," the IRS was ordered by the General Services Board of Contract Appeals to terminate its contract with Computer Systems and Resources, Inc. when they found that the awardee did not meet all of the Service's technical requirements. The decision provided that the IRS could either recompete the contract or award it to Sysorex, a firm that did meet all of IRS' stated requirements. The IRS awarded the contract to Sysorex on February 11, 1986.

Subsequently, Sysorex experienced difficulties during the development of custom software for the new terminals and communication processors. This phase of the project was originally scheduled to be completed by July 1986, but was extended to October 1986. To ensure that the system meets specifications, the contract requires a number of tests at the National Computer Center (NCC). The new communication processor did not successfully pass the first test due to the software problems. A cure letter was issued to Sysorex by the Service in November 1986, requiring an explanation of the reasons for the failure and a plan describing the steps which would be taken to cure the problems. Sysorex responded with a cure plan which was accepted by the Service. A delay of five months is estimated for the redesign.

B. Could this delay have been avoided?

Given the vagaries of the contractual process and the magnitude of the communications system being designed and developed, we do not believe that all delays were avoidable. These two instances would not have occurred if the respective vendors had met the Service's contract specifications. With regard to the Sysorex contract, there have been significant penalties imposed on the contractor for failure to meet contract specifications. Liquidated damages were operative from July 24, 1986, to October 28, 1986. By IRS letter dated January 14, 1987, Sysorex was informed that the amount of damages is calculated at $5,000 per calendar day times 96 days for a total of $480,000.

In addition, the Service only paid approximately 50% of the $14 million billed by Sysorex. Of the remaining $7 million, IRS is paying 50% in partial payments as each software milestone is completed, until the NCC system is ready for use. The remaining 50% for software development will be paid upon the successful completion of acceptance testing of the NCC system. There will be no additional charge for deliverables which must be redesigned and redelivered since the original items were not acceptable.

C. What assurances are there that there will be no further delays?

Sysorex has agreed to make the design changes needed to comply with the specification and has extensively involved IRS personnel in the CRS redesign. The redesign of the communications software is proceeding on schedule and, in conjunction with the General Accounting Office (GAO), we continue to work closely with the vendor. By careful and thorough monitoring of the quality of deliverable products, we are jointly working to ensure that the final product satisfies our requirements.

GAO is conducting a separate investigation regarding this question.

12. What are the capacity problems associated with the front-end processors? What service centers, if any, are currently experiencing these problems? Austin, Fresno, Atlanta, Ogden?

The maximum limitation of 900 terminals is the primary capacity problem associated with the front-end processors.

Currently, the Austin, Fresno, Atlanta and Ogden Service Centers are at the maximum terminal capacity. Real time hours have been extended in all service centers (6 a.m. to 12 Midnight) to obtain the highest possible processing capacity, improved response time and workload manageability.

We are experiencing very few hardware downtime problems with the front-end processors during this filing season.

13. Assuming that the front-end processors will be replaced, how long can IRS continue to use the current computer system?

The Service has initiated a series of actions which will enable us to anticipate and accommodate the tax processing systems' capacity requirements through 1992. (See response to Question 14.)

14. In the interim, is IRS planning to acquire any more computer systems or enhancement initiatives? Will you have to delay or "stretch-out" existing workloads until TSR is in place? What is the revenue impact of this?

The establishment of a multifunctional task force was approved by the Deputy Commissioner on December 9, 1986, and assigned responsibility for developing plans to ensure service center computer capacity until 1992 and beyond. The task force is charged with the development of an action plan that will check growth in the size and number of programs and files in order to provide the capacity needed until the new systems can be procured, installed and tested.

In conjunction with this action, the Service is currently exploring the use of an outside contractor to assist in enhancing our forecasting ability. The Service is also implementing an IRS Capacity Management Methodology which will (1) provide a baseline model that establishes and characterizes existing systems workloads, and (2) project the impact of anticipated workload growth on current systems capacity. Utilizing modern workload forecasting and modeling techniques, these estimates will be continually revised to reflect the actual workload volume. In addition, based on information from the workload characterization, modeling and forecasting activities, the capacity plan will recommend actions to be taken in managing each of our systems. The plan will identify capacity problems and bottlenecks and will propose possible solutions. Workload priorities will be ranked after consultation with IRS officials requesting services. Each capacity problem will be reported to management along with an explanation of its cause, the operations impact, and the options for resolution.

Any actions taken by the Service to ensure that adequate tax processing systems capacity exists through 1992 will be done to preclude a negative revenue impact.

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

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The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth Building
Washington, DC 20515

Dear Mr. Chairman:

Earlier this year, Commissioner Gibbs testified before your Subcommittee on the progress of the 1987 tax filing season. The preliminary information available then was very positive, and the final data available now is even more so.

Overall, the 1987 filing season was one of the best that IRS has ever had. Through the end of May, we received nearly 98.4 million individual income tax returns, an increase of some 1.4 million returns over 1986. We processed over 85.4 million of these returns, an increase of about 2.9 million or 3.5% over 1986.

During this same period, IRS certified over 68.7 million refunds, some 281,000 more than in 1986. These refunds totalled some $60.3 billion, an increase of $526 million over 1986. The average refund in 1987 was almost $878, up from nearly $874 last year.

Over 37.7 million technical tax law, refund, account or forms requests were responded to by IRS in preparing for and during this filing season. This total includes 25.5 million inquiries on our toll-free telephone system and some 12.2 million forms requests.

We also saw major positive changes in our adjustment and unpostable inventories. (Adjustments are cases involving changes/corrections to taxpayers' tax accounts. Unpostables are cases involving tax returns or related documents that have completed service center processing but cannot "post" to the master file.) At the end of May, adjustments were 44.4% lower than in 1986, and because of our quality initiatives 1987 adjustment receipts are 20.3% lower than at this time last year. Unpostables were 40.6% lower than 1986 levels, and our quality initiatives in this area have resulted in a 16.1% decline in unpostable receipts in 1987. We continue to closely monitor these areas for additional improvements.

While we are pleased with the 1987 tax filing season, we are not satisfied. We realize that we need to do more to assure the accuracy of our telephone responses to taxpayers, especially in light of Tax Reform Act changes. We are addressing this and a number of related issues now as we implement the provisions of the Act, and prepare for next year's filing season.

I appreciate the opportunity to share our filing season successes with you, and would encourage you and your staff to contact us with any questions you may have regarding the implementation of the Tax Reform Act.

With best wishes, I am

Sincerely,

Bryan Slone
Assistant to the Commissioner
(Legislative Liaison)

News Release

Department of the Treasury
Internal Revenue Service
Public Affairs Division
Washington, DC 20224

Media Contact: Tel (202) 566-4024
Copies: Tel (202) 566-4054

For Release: Mar. 2, 1987

IR-87-16

Washington -- The Internal Revenue Service today released a short version of the federal income tax withholding certificate -- a Form W-4A -- that it has forwarded to the Office of Management and Budget for clearance.

The IRS also said that taxpayers will not be penalized if they are underwithheld for 1987 as long as they make a good faith effort to comply with the law and file a new withholding certificate by June 1, 1987.

The new Form W-4A, which would be available four to six weeks after IRS receives approval, is an alternative to the longer version of the federal withholding certificate released last November. The IRS issued the Form W-4 because of changes made by the Tax Reform Act of 1986 and because Congress requested the IRS to make withholding more accurately match taxpayers' income tax liability. According to the IRS, the new form would provide an easier way to figure withholding allowances than the earlier four-page W-4 form.

At a news conference held here today the IRS emphasized that employees who have already filed a 1987 Form W-4 with their employers will not need to file again.

The IRS said that the two-page Form W-4A was developed to address taxpayers' concerns that the four-page version was too complicated for many taxpayers who do not have complex tax

(more)

situations. The front page of Form W-4A includes a worksheet for taxpayers who claim allowances only for personal exemptions, age or blindness or at least $1,500 of child or dependent care expense.

Taxpayers will generally find it beneficial to file the longer Form W-4 if the taxpayer's financial situation is more complicated, including substantial amounts of interest or other nonwage income. Also, taxpayers who wish to claim allowances for tax credits other than the child and dependent care credit allowed on the short form should file Form W-4.

The IRS noted further that taxpayers who want to get a refund or increase a refund amount may compute their W-4A or W-4 to closely match their tax liability and then decrease the number of withholding allowances they claim on the form filed with their employer.

Because some taxpayers may not have changed their withholding before a portion of this year has passed, the IRS today urged them to monitor their withholding carefully to avoid underwithholding or unwanted overwithholding, using IRS Publication 919, "Is My Withholding Correct?". A worksheet in that publication takes into account tax that has been withheld in 1987 and projects revised withholding for the remainder of the year. Publication 919 is available from IRS centralized distribution sites by mail order or by calling 1-800-424-FORM (3676) (In Alaska, call the IRS "Forms Only" number in your local directory.)

v v v

March 2, 1987

MEMO TO TAX SERVICES

Attached is an advance copy of Announcement 87-16 relating to waiver of penalty for underwithholding. This announcement will appear in Internal Revenue Bulletin 1987-11, dated March 16, 1987.

You may release this announcement immediately.

Public Affairs Division

Waiver of Penalty for Underwithholding

Announcement 87-16

The purpose of this announcement is to advise taxpayers of the circumstances in which the Internal Revenue Service will waive penalties for individuals who fail to have a sufficient amount of federal income tax withheld from their wages. This announcement applies only for taxable years beginning in 1987.

Background. The Internal Revenue Code requires individuals to make timely payments of their estimated income tax liability. An individual whose income consists solely of wages generally satisfies this obligation if he or she files a properly completed withholding exemption certificate (Form W-4 or Form W-4A) with his or her employer, who is required to withhold the tax from the individual's wages.

Section 6654 of the Code imposes a penalty on individuals who fail to make timely payments of their estimated tax. In general, for the 1987 taxable year an individual avoids this penalty if his or her wage withholding and quarterly payments are at least equal to 90% of the individual's 1987 tax liability or 100% of the individual's 1986 tax liability.

Waiver of Penalties. Because of the substantial number of changes made to the tax law by the Tax Reform Act of 1986, concern has been expressed that many individuals may fail to have the minimum amount of tax withholding necessary to avoid the section 6654 penalty. Although the Code imposes a penalty on individuals who fail to have enough tax withheld from their wages, the Internal Revenue Service has the authority not to assert the penalty in unusual circumstances in which the imposition of the penalty would be inequitable. Pursuant to this authority, the Service will waive the penalty attributable to the underwithholding of tax on wage income of any individual who files a 1987 Form W-4 or W-4A with his or her employer on or before June 1, 1987, provided that the taxpayer has not filed the form in bad faith.

This waiver of the penalty will not apply to income from non-wage sources, such as self-employment income and investment income. With respect to such non-wage income, the taxpayer ordinarily will avoid the penalty only if he or she can establish that the failure to meet the estimated tax requirement resulted from reliance on the 1987 Form W-4 or W-4A. This waiver will also not apply if the taxpayer does not file a 1987 Form W-4 or W-4A on or before June 1, 1987.

Additional Considerations. The policy described in this announcement is intended to provide an equitable solution to the unusual circumstances involving the 1987 Form W-4. Taxpayers should be aware, however, that the waiver applies only to the penalty for underwithholding attributable to

wages. The Service cannot forgive any tax liability that taxpayers may owe at the end of the year because of underwithholding. To minimize the potential for underwithholding in 1987, the Service urges employees who have not already filed the new Form W-4 to file a Form W-4 or W-4A with their employer as soon as possible. Finally, it is important to emphasize that even a corrected Form W-4 or W-4A will not take care of underwithholding for the period occurring before the Form is filed; accordingly, even those taxpayers who file a Form W-4 or W-4A by June 1 may wish to consider having an additional amount withheld from their pay for the remainder of the year.

Chairman PICKLE. Now the Chair will ask our two Commissioners if they are still here, former Commissioners, Mortimer M. Caplin, Esq., with Caplin & Drysdale—give you a little plug there Mr. Caplin—and Donald C. Alexander, who is with a larger firm, Cadwalader, Wickersham & Taft.

You two Commissioners please come forward and we will be pleased to hear from you.

Thank you for staying with us. I know you have heard Commissioner Gibbs, and you are probably saying, "There but for the grace of God," or at least your sympathies were with him. You have been there. You know the problems he faces. You have given us great service.

We appreciate the service you have given to the Nation, too. We would be pleased to hear from you.

STATEMENT OF MORTIMER CAPLIN, ESQ., CAPLIN & DRYSDALE, WASHINGTON, DC, FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. CAPLIN. Mr. Chairman, thank you.

It is a privilege to be invited here and participate in these hearings.

I do sympathize with Commissioner Gibbs, having sat in the same seat before. I also want to express the highest praise for the direction in which he is moving. He is doing an outstanding job and is providing a fresh spark to the Service.

I have some concern though, about two developments that have occurred which I think will have a serious and negative impact on the Service. One is the inordinate number of penalties that recent tax statutes impose on taxpayers; and secondly, the nondeductibility of tax deficiency interest for individuals—tantamount to a no-fault penalty—which was mandated by the 1986 Tax Reform Act.

Both of these points that I want to make relate to legislation, not something the IRS is doing but what Congress has enacted over recent years. The growing battery of penalties adopted in 1981, 1982, 1984, and 1986 flies in the face of the whole system of voluntary compliance and self-assessment which we regard as the American way in taxation.

A compliance penalty—which you might call revenue-raising by penalty—hardly brings cooperation, a necessary ingredient in our tax system. Rather, it occurs in a setting that tends to be abrasive and antagonistic. There are some revenue agents, too, who can be rather heavy-handed in asserting penalties for what are revenue-raising purposes.

In such an environment, the IRS ability to carry out its mission is markedly more difficult. The IRS publishes a mission statement which provides that one of its primary goals is to encourage and achieve the highest possible degree of voluntary compliance. Year after year, despite the underground economy and all the pockmarks we have on our system, over 96 percent of tax collection actually comes from self-reporting and withholding—really, what the American taxpayer puts right on the table.

This high level of self-reporting is the miracle of our system, the fact that we can get this degree of compliance from the public. In

1985, for example, there were some $743 billion of gross collections, with only $24 billion coming from direct enforcement. I don't want to minimize direct enforcement, because it has a major bearing on improving compliance. But, nevertheless, it does tell you something: that the American taxpayer is doing something very positive.

In raising public revenue, is extremely important that you have the support of the public. In this regard, taxpayer attitudes and taxpayer confidence in our self-assessment process are vital. And to gain this confidence, tax administrators must demonstrate their concern about whether the system is fair, whether taxpayers are being treated alike without favor to one as against the other, whether the law is being enforced in an even-handed manner—with courtesy, confidentiality, a sensitivity to the difficulties the taxpayers face—and without overreaching or overuse of the extraordinary power that Congress has given to the Service.

When you rely on a regime of penalties, some 150 provisions today, you find yourself inconsistent with the tradition of this country, dating back to the first income tax law of 125 years ago. Commissioner Gibbs recognizes this. He cautioned the other day, "Practitioners have expressed concern that penalties poison the atmosphere of tax administration, because they set up an adversarial situation."

He says, "In giving the impression that tax dollars are being extracted rather than collected, they say we are sending the wrong signal."

The Commissioner also indicated his personal concern when he said that he was worried about the impact of penalties on taxpayer behavior, including the cumulative effect of such a variety of penalties at such high dollar amounts.

I hope the subcommittee will focus on this and reexamine the whole battery of penalties that have been adopted, and weigh their impact on the ability of the Service to run the type of system we have long had in this country. In my view, what we need is more extensive and more intensive audits of returns. This committee seems to agree; for it has given strong backing to the Service's repeated request for additional personnel to carry out this function.

Let me mention the second point, the nondeductibility of tax deficiency interest. The 1986 act denies individuals—not regular corporations, but individuals—the right to deduct tax deficiency interest. This is in the new code section 163(h).

Despite a 4-year transition period, this retroactive disallowance of interest deduction is equivalent to a no-fault penalty on taxpayers—taxpayers who often find themselves innocent victims of administrative delays, largely beyond their control.

I will point to the tax shelter area as an example. There are some 400,000 returns sitting out in the field being held in suspense by the IRS, with interest running against the taxpayer day after day; and this interest will be nondeductible after the transition period. This new rule, in my view, is certain to have a profoundly adverse impact on IRS administrative appeals, settlements, and tax litigation.

Let me make four brief points here. One, the nondeductibility of accruing interest will press taxpayers to strive for a resolution of

disputes as early as possible. That is not bad. But these expensive time pressures—with the clock ticking away on nondeductible interest compounded day after day—will simultaneously give IRS revenue agents added leverage in the negotiating process.

Secondly, to avoid immediate conflict and delay, some taxpayers will by-pass the administrative process entirely, contrary to IRS desire to have disputes resolved in its appeals offices. They will move directly into the courts, which are already overcrowded with heavy judicial dockets.

Related to this, the third point is that the wealthier taxpayers will have incentives to select the refund route—pay the proposed deficiency, file a claim for refund, and then sue for a refund in the U.S. Claims Court or district court. Here, the interest factor works in favor of the taxpayer for he becomes the recipient of the interest on any refund, albeit at the new lower and differential rate.

I should add that, despite this advantage, there are many taxpayers who just don't have the resources to pay the tax up front and then follow the refund route.

My last point here is that disallowing the deduction for interest on tax deficiencies and, at the same time, taxing interest received on refunds foster the impression that the rules of our tax system are unfairly biased in favor of the Government.

This appearance of unfairness is especially striking in cases where the underlying tax dispute is a matter of timing. Are you entitled to the deduction in this year or the next? What is the proper year to report the income?

Such a controversy involving the shifting of income, or shifting of a deduction, often results in a tax deficiency for one year and a tax refund for another—with interest accruing in tandem against the taxpayer in the deficiency year, and for him in the refund year.

Tax policy theoreticians may be able to justify a different tax treatment for the interest paid and the interest received—one being nondeductible; the other one taxable. But most taxpayers will surely feel that the two amounts in this type of dispute ought to be netted against each other without generating additional tax liability.

The nondeductibility of deficiency interest is an important provision. I respectfully ask this committee to give it consideration along with a revision of the battery of penalties that I mentioned at the outset.

Thank you. I would be glad to answer any questions.

[The statement of Mr. Caplin follows:]

Statement by

MORTIMER CAPLIN
Caplin & Drysdale
Washington, D.C.

HEARINGS BEFORE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

Room 1100, Longworth House Office Building
10:00 a.m., February 6, 1987

My name is Mortimer Caplin, a member of the Washington law firm of Caplin & Drysdale. I served as Commissioner of Internal Revenue under Presidents Kennedy and Johnson from early 1961 to mid-1964. It is a privilege for me to participate in these hearings.

I have the highest of praise for the direction in which the IRS is moving, but I wish to express my concern about the negative impact on tax administration resulting from two current developments: (1) the inordinate number of penalties that recent tax statutes imposes on taxpayers, and (2) the nondeductibility of tax deficiency interest--which is tantamount to a no-fault penalty--mandated by the 1986 Tax Reform Act.

Proliferation of Penalties

The growing battery of penalties recently enacted flies in the face of the voluntary compliance and self-assessment concepts of the American way in taxation. Compliance by penalty hardly breeds cooperation--rather, it occurs in a setting that tends to be abrasive and antagonistic. Some revenue agents, too, can be heavy handed in asserting penalties for revenue-raising purposes, and in such an environment IRS' ability to carry out its mission is markedly more difficult.

As the IRS points out in its mission statement, one of its primary goals is to "encourage and achieve the highest possible degree of voluntary compliance." And, year after year--despite the underground economy and other pockmarks on the system--over 96% of tax collections actually comes from self-reporting and withholding. In 1985, for example, gross tax collections totaled $743 billion, with only $24 billion coming from direct enforcement activities--delinquent accounts, delinquent returns, Service Center corrections, and recommended additional taxes and penalties.

Direct enforcement, of course, has a major bearing on improving compliance. But equally important is taxpayer attitude and confidence in the self-reporting process: whether it is fair; whether taxpayers are being treated alike without favor to anyone; whether the IRS is administering the law in an evenhanded manner, with courtesy, with sensitivity to the difficulties faced by taxpayers--and without overreaching or overuse of the extraordinary power that Congress has granted to it.

Reliance on a regime of penalties--some 150 provisions today--is inconsistent with the tradition that has prevailed in this country, dating back to our first income tax law 125 years ago. As Commissioner Gibbs cautioned the other day:

> "Practitioners have expressed concern that penalties 'poison' the atmosphere of tax administration because they set up an adversial [sic] situation. In giving the

impression that tax dollars are being extracted rather than collected, they say, we're sending the wrong signal."

The Commissioner also indicated his own concern "about the effect of penalties on taxpayer behavior" and the "cumulative effect on the tax system of such a variety of penalties and the high dollar amounts."

I hope that the Subcommittee will focus on this proliferation of penalties, review them as a group, and weigh their impact on the ability of the IRS to function efficiently and effectively. Under this country's established system for collecting taxes, more extensive and more intensive examinations of returns are far better suited for the task of narrowing the revenue gap.

Nondeductibility of Tax Deficiency Interest

Related to this is the 1986 Act's denial to individuals of the right to deduct tax deficiency interest. (Code section 163(h).) While a four-year transition period is given, this retroactive disallowance of interest deductions is equivalent to a no-fault penalty on taxpayers--taxpayers who often find themselves innocent victims of administrative delays and logjams beyond their control.

In my view, this new rule is certain to have a profoundly adverse impact on our system of IRS administrative appeals, settlements, and tax litigation:

1. Nondeductibility of accruing interest will press taxpayers to strive for as early a resolution of disputes as possible. But such expensive time pressures will simultaneously give the IRS agents added leverage in the negotiating process.

2. To avoid conflict and delay, some taxpayers will bypass the administrative process entirely--contrary to IRS' desire to have disputes resolved in appeals offices--and move directly into the courts, adding to already crowded judicial dockets.

3. Wealthier taxpayers will have extra incentives to select the refund route: pay the proposed deficiency at once, file a claim for refund, and then sue for a refund in the U.S. Claims Court or a U.S. District Court. Here, the interest factor works in favor of the taxpayer, for he becomes the recipient of interest on any refunds--albeit at the new and lower differential rate. Despite this advantage, however, many taxpayers do not have the resources to finance pursuit of the refund alternative.

4. Disallowing deductions for interest paid on tax deficiencies, while taxing interest received on refunds, fosters the impression that the rules of our tax system are unfairly biased in favor of the government. This appearance of unfairness is especially striking in cases where the underlying tax dispute is a matter of timing--over the proper year to report an item of income or claim a deduction. Such controversies often result in a tax deficiency for one year, and a refund for another, with interest accruing both against and for the taxpayer.

Tax policy theoreticians may be able to justify a different tax treatment for the interest paid and the interest received, but most taxpayers will surely feel that the two amounts ought to be netted against each other, without generating additional tax liability.

I strongly urge the Subcommittee to reconsider the wisdom of disallowing this interest deduction, particularly in light of the difficulty it creates for fair and proper tax administration.

Mr. RANGEL [presiding]. Commissioner Alexander.

STATEMENT OF DONALD C. ALEXANDER, ESQ., CADWALADER, WICKERSHAM & TAFT, FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. ALEXANDER. Thank you.

I have a statement to insert in the record. As a matter of fact, I have never read a statement all the times I have appeared before this subcommittee and various other committees. I think I hold the world's record for testifying.

I want to thank this subcommittee for having this oversight hearing and having another one on the IRS budget. And also, Chairman Pickle, I think you announced you will have more during the hearing this morning.

Oversight—I guess like castor oil—doesn't taste good going down, but it is good in the long run. This is therapeutic for the tax system. This room, 1100 Longworth, is a good place to have oversight hearings, unlike certain other buildings which can go unnamed.

I am delighted Larry Gibbs is here as Commissioner of Internal Revenue—not because I am no longer Commissioner, being out almost 10 years—thank God for that—but because I had the privilege of working with Commissioner Gibbs when I was with IRS. They could not have picked a better person—dedicated, intelligent, a fine public servant, who is going to have a tough job to do. Part of that job we talked about this morning.

Chairman Pickle, I am delighted to see you are interested in Taxpayer service. I hope you keep it up. Taxpayer service has been neglected in the last few years, for whatever reasons. Those reasons don't make sense. The Government has no business calling on a taxpayer to file a complete tax return and telling the taxpayer, by the way, I am not going to tell you how to do it. I hope that the Service can give better information, more accurate information, to more people. I hope those telephones are answered more often than not answered, as they have been the past few years.

Like you, I don't like to have an automated voice telling me something. Maybe I didn't know how to ask the question right. Maybe the automated voice doesn't know the answer to the question that was being asked.

The IRS, thank goodness, has finally been able to persuade Treasury and OMB that it is a profit center. If you want to balance the budget, a good place to start is to give the IRS sufficient resources to do its job right, and do it effectively. That is good. I hope it lasts.

One problem the IRS has, though, is staffing up. How can you use that money? How do you hire people? Well, if you have to hire them at the wrong time or at noncompetitive rates, you are not going to get good people. You really need good people to try to do the enormously difficult job that IRS has, and that job is going to be compounded by the 1986 Act.

My friend, former Commissioner Caplin, talked to you about penalties; he explained that he thinks they are overdone. Maybe they

are. Maybe we have at last gone too far in the 1986 act, particularly the flap on the penalty for substantial understatement.

Mr. CAPLIN. It's 25 percent.

Mr. ALEXANDER. It's 25 percent now; 20 in the 1986 act. And they passed something that took precedence over the act. But the tax system does not enforce itself. Maybe 96 percent of the revenues are collected from voluntary compliance, but what goes uncollected? Heck, if the system only produces 10 percent of the revenues it ought to, 96 percent of that 10 percent would presumably still be collected by voluntary compliance. But voluntary compliance would be at an unacceptably low level. It is at a pretty low level now.

Compliance has been going down regularly. The tax gap last year was estimated by IRS to be over $100 billion. If somehow the system worked perfectly, there would be a lot less talk about Gramm-Rudman and balancing the budget because the budget would be pretty closely in balance.

The tax system can certainly work better than it has been working. To make it work you need to have an effective IRS, but you need to have a downside risk on the taxpayer.

Taxpayers will find, and people who should be taxpayers will find; most people comply—there are some that don't—that if you have a game in which the losers win, it is silly not to play that game. Without penalties and without an effective rate of interest, that would be the game, and that was the game quite a while. The losers won.

If you were audited and had to pay up, all you paid was the tax you owed, plus interest, and you paid interest at a rate well below what you would have had to borrow from another person. So penalties are needed. Strong penalties are needed.

Maybe we have gone too far. Like former Commissioner Caplin, I don't like to see dollar revenues placed on penalties and penalties used as a way to balance the budget. That is not the way to go. But without a genuine downside risk, it is going to be very difficult to improve compliance with the tax laws.

Finally, tax reform. What bothers me about it most, from the standpoint of tax administration—and that is what this hearing is all about—is the additional burdens, the incredible complexity of some of these provisions that have been put on IRS to try to administer the law and taxpayers to try to comply with the law. The alternative minimum tax, we don't need a two-track tax system. Particularly, we don't need a tax system that tries to tax book income. The problems revenue agents will have are almost unthinkable.

We don't need three different kinds of income—active income, portfolio income, passive income. We don't need to have five different kinds of interest.

It is very difficult to expect taxpayers to comply with these very complex provisions which I think were added by the other body, and it is very difficult to expect IRS to be able to administer them effectively.

Thank you.

[The statement of Mr. Alexander follows:]

STATEMENT OF DONALD C. ALEXANDER
OF CADWALADER, WICKERSHAM & TAFT
before the
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
February 6, 1987

My name is Donald C. Alexander and I am a partner in the Washington office of Cadwalader, Wickersham & Taft. I am appearing at the request of the Subcommittee in my personal capacity as a tax practitioner and former Internal Revenue Service executive.

First, I want to express my appreciation to the Subcommittee on Oversight for conducting these hearings. Congressional oversight of a probing, skeptical but constructive nature, is essential to sound tax administration. And this Subcommittee, with its companion in the Senate, is the proper group to exercise oversight rights and responsibilities. I hope that you can find the time to have regular oversight hearings targeted to major activities of the Internal Revenue Service.

It is good to see a long-overdue substantial increase in the Internal Revenue Service budget. At last the Administration is viewing the Internal Revenue Service as a profit center which, indeed it is. Adding to IRS resources can result in four to seven dollars, or more, of additional revenue collected for every additional dollar spent. Of course, if additional resources are assigned to collection, the marginal yield -- for the time being, at least -- will be much higher. Nevertheless, concentrating on the margin is not necessarily the best course; while additional resources are undoubtedly needed in IRS' enforcement activities, additional resources are also needed to process tax returns and to deliver adequate taxpayer service.

As to taxpayer service, I am concerned about an apparent indication (page I-S25 [Budget of the United States Government, Appendix, Fiscal Year 1988]) that the number of taxpayers assisted by IRS will decline substantially from 1986 levels. If so, this would be quite unfortunate; although it may not be possible to measure the increased compliance (and revenue) that results from adequate taxpayer service, basic fairness requires that a government which calls on its citizens to file complete and correct tax returns should not turn away when its citizens seek aid from it to meet their responsibilities.

Although IRS would be given increased funding and would be authorized to employ more people to do a more effective and responsive job, this is only part of the problem. Hiring good people requires IRS to be able to make offers at the right time and at the right price. If IRS is out of the market, IRS won't be able to find the competent and dedicated people that it needs. The budgetary process is not designed to permit IRS to compete effectively for top accounting graduates. IRS hires too late in the year. More important, IRS is not really in the market. The starting salary at the GS-5 level, the basic entry level for a revenue officer or tax auditor, is only $14,822. The starting salary at the GS-7 level for a typical new Revenue Agent (with an accounting degree) is only $18,358. An IRS attorney-advisor starts at GS-9 or GS-11 at $22,458 or $27,172. These salaries are not competitive with the private sector. If under present rules entry level pay cannot be raised to attract the people IRS needs to interpret and apply the 1986 Internal Revenue Code, innovative legislative solutions should be fashioned.

We have heard much about the tax gap in recent years, and indeed a substantial reduction of the estimated gap of more than $100 billion would go far toward solving our present budgetary problems. Increasing IRS' ability to cope with its responsibilities is one essential ingredient for solution. Another is making noncompliance uneconomic by imposing a genuine downside risk upon those who would game the system. New and greatly increased penalties, together with increased interest charges (now nondeductible to individual taxpayers) go far toward creating this risk. Of course, civil penalties must be buttressed by an effective criminal deterrent.

Armed with a broad array of new weapons, IRS has new responsibilities to use them effectively but not overzealously. Loose cannon approaches will be counterproductive in the long run; courts should strike down excesses and what Congress has granted, Congress can take away. We all remember withholding on interest and dividends and automobile logs. I question the wisdom of assigning budgetary revenues to increased penalties, for predictions can be easily translated into imperatives. This sounds like a quota system, and that is precisely what we should not have in IRS' enforcement of the tax laws. There are strong indications that certain penalties are already being applied in excessive ways by some IRS agents. If the Members of the Subcommittee have not yet heard about this, you will probably soon hear. I hope that the response will be to call on IRS to exercise its responsibilities prudently rather than to take away deterrents which are necessary to create the downside risk required for effective enforcement. But let's not add any new penalties or increase penalties further; enough is enough.

As I have stated before, I am sorry to see the Internal Revenue Service being used as the all-purpose bill collector of the United States. Those who comply with the tax laws but are derelict in meeting other responsibilities are not slow to discover that continued compliance with the tax laws has unattractive side consequences. Short-term gains may well be more than counterbalanced by long-term losses in lessened voluntary compliance with the tax system.

Finally, Congress made long strides in the 1986 Tax Reform Act toward improved tax administration when it reduced rates and broadened the tax base. However, some steps were taken in the wrong direction. Prime examples of the latter are the alternative minimum tax and the passive loss rules. Imposing a two-track tax system increases IRS' enforcement problems exponentially. If one were to try to devise a tax which is unadministrable, the product might be close to the 1986 Act's corporate alternative minimum tax which includes book income in its base. As the Supreme Court has stated:

> Finally, a presumptive equivalency between tax and financial accounting would create insurmountable difficulties of tax administration. Accountants long have recognized that 'generally accepted accounting principles' are far from being a canonical set of rules that will ensure identical accounting treatment of identical transactions. 'Generally accepted accounting principles,' rather, tolerate a range of 'reasonable' treatments, leaving the choice among alternatives to management. . . . If management's election among 'acceptable' options were dispositive for tax purposes, a firm, indeed, could decide unilaterally - within limits dictated only by its accountants - the tax it wished to pay. Such unilateral decisions would not just make the Code inequitable;

> they would make it unenforceable. (Footnotes omitted.)
>
> *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 544 (1979).

Similarly, the passive income rules create great complexity, and together with the various limitations on the deduction of interest, will produce great audit problems. Distinctions must be made between passive income, active income and portfolio income. Interest must be allocated to passive loss interest, nondeductible personal interest, home mortgage interest, active business interest, and investment interest. Is it reasonable to believe that taxpayers will comply? If not, is it reasonable to believe that the Internal Revenue Service will be able to require them to comply with a schedular tax system?

Effective tax administration requires a sound and understandable law to administer. While the 1986 Code in many ways is better than its predecessor, I hope that some of the warts will be removed, even if rates must be adjusted slightly to permit such removal.

Mr. RANGEL. The committee is real gratified that both of you come back from time to time to share your views with us. I don't really think on the question of penalties and the volunteer system that both of you are saying the same thing.

Mr. CAPLIN. I don't think we are quite as far apart as it sounded.

Mr. ALEXANDER. I think we are pretty far apart, Mort.

Mr. CAPLIN. We have always had a system of penalties—a negligence penalty, and fraud penalties. I think it is terribly important to have a vigorous enforcement policy backing up our compliance efforts. But it is a matter of degree.

If you look at 150 penalty provisions, you find it is like a plumber's code now. In the name of sound tax administration, I hope that revenue agents will not use this system of penalties as part of the bargaining process in disposing of tax returns under active audit.

I had the occasion recently to examine something called a 30-day letter issued by the IRS to a corporation listing about 15 items of adjustment. The substantial understatement of income tax penalty was imposed against each item, with no inquiry as to whether there was substantial authority and the like to support the taxpayer. I regard that as abusive.

Mr. RANGEL. Maybe you could help us. If you could take a look at the 150 provisions and see which ones don't lend themselves to fairness and equity, but it is clear to me and Dick Schulze that what makes a voluntary system work is the fear of sanctions and penalties. If you could help us out as to specifically what you are talking about. I know you don't mean to waive all of the penalties.

Mr. CAPLIN. Not at all. I'm talking about the trend—the mounting number of penalties.

Mr. RANGEL. But having too many of them does give the appearance of being heavy-handed. The answer has to be in the middle.

Mr. CAPLIN. A full study would be a large undertaking. I hope the Government itself, the Treasury, and the IRS, will examine the entire battery and make some recommendation.

Mr. RANGEL. We normally wait until there is an outcry or an appeal that something we have enacted is not working.

Mr. SCHULZE. Will the gentleman yield?

Mr. Caplin, are you just saying that perhaps the parameters under which penalties are applied should be loosened?

Mr. CAPLIN. No. I am really saying we shouldn't have 150 provisions on penalties. We got along for an awfully long time with a handful. I really think the answer lies in expending the IRS audit program. Instead of auditing 1.22 percent of the returns, we should move back to auditing something closer to 5 percent plus, as we did in the mid-1960's.

Mr. ALEXANDER. Those were single-issue audits. I hope we can audit 2.6 percent of the returns effectively rather than 5 percent ineffectively.

Mr. CAPLIN. I won't debate those numbers. I think the IRS would say that the 5 percent were effectively audited, too. The points is that there ought to be a much broader coverage. The percentage is totally inadequate today.

What is happening in the tax profession is very important, too. Through a proposed amendment to Treasury Circular 230, a definite attempt is being made to raise the standards for return pre-

parers and the tax professions in general. These people are handling millions of returns; and if they have a mandatory and higher degree of obligation, with enforcement by possible suspension or disbarment—the inability to practice before the IRS—I think that is going to have a meaningful impact on our entire tax system.

Mr. SCHULZE. You will agree there was some gaming of the system?

Mr. CAPLIN. Of course, some extreme abuse. The growing underground economy that we hear of is quite disturbing.

What this committee is doing in supporting the increase in IRS staffing is crucial—giving the IRS the tools to do its job properly. What I am saying is that Congress is making excessive use of penalties to administer the tax law. I am not, by a long shot, saying eliminate penalties. Nor am I saying eliminate criminal penalties. They are important elements in a tax system. But don't go overboard.

Mr. RANGEL. Mr. Chairman?

Chairman PICKLE. Thank you, gentlemen, for appearing.

Let me go back to the cat fight we hear more about than anything—the W-4 form. Do you think the form they have issued is complicated? Can it be simplified? Should it be changed and made more simple? What would you do?

Mr. ALEXANDER. Mr. Chairman, I worked on that W-4 form for my wife. One came to her and she was confused by it.

Chairman PICKLE. Did you say "confused" or "amused"?

Mr. ALEXANDER. She was confused. She was not amused. My wife is rarely amused by tax forms, Mr. Chairman. She certainly was not amused by this one.

I thought it was an improvement—got larger print than the last one. The other took up less pages, but if you put the same words in the same type, you would find the other wouldn't fit very well.

I worked it out. It took me 45 minutes. Of course, I did it wrong. I was pretty close. I can sympathize with Commissioner Gibbs and the IRS on trying to reconcile the desire to have simple forms. Remember, that was my original objective when I went in office. I soon found out that the objective was to keep the boat afloat—having simpler forms was secondary. Now IRS is trying to comply with the directions given by Congress, trying to make withholding match actual liability.

I think I would have opted—God only knows what you would do if you have full information. Or the information I have, I think I would have had two forms. I would have had a W-4-A, and W-4, EZ instructions for the vast majority of people, and the more complex instructions for the other folks. You wouldn't have to get down to that question about, are you elderly and blind, and the taxpayer said, "I wasn't before I started this form."

Mr. CAPLIN. I was rather encouraged by what Commissioner Gibbs had to say. He seemed fairly sanguine about the IRS ability to prepare a 1040. My feeling is "you ain't seen nothing yet," when you get to your 1040.

Mr. ALEXANDER. It is going to be easier for the ordinary taxpayer, Mort. I applied the 1986 Revenue Act to the 1985 1040, and I eliminated eight lines on the 1040. It is going to be simpler. The

people who are yelling about complexity are those that make money out of scaring the public.

Mr. CAPLIN. You wait until Mr. Alexander comes back next year and talks about simplicity on that. Particularly with transition rules on interest, passive losses and the like.

Mr. ALEXANDER. I agree with you on passive losses. I am telling you the ordinary taxpayer's job is going to be a little easier, and the tax return preparers ought to stop trying to scare people.

Mr. CAPLIN. I am happy to say we have a firm of about 50 lawyers, and we don't prepare a single return.

Chairman PICKLE. You are all like a bunch of rabbits jumping before we get out in the pasture.

Mr. CAPLIN. The tax returns merely reflect the tax law. If Congress enacts a tax law that is difficult to administer, the tax return will encounter difficulties in communicating simply or adequately. I think that this W-4 really reflects the new statutory provisions, the broader brackets and the need to have a 90 percent compliance.

Chairman PICKLE. I think I would agree with you, the present form does reflect what the tax bill required. Basically I don't find fault with that. The question is, is it too complex, too difficult? Is it too hard to fill out?

Mr. CAPLIN. I think it is very complex.

Chairman PICKLE. My question is, I would like a simple answer. Should the IRS produce a more simplified W-4 form?

Mr. ALEXANDER. Yes.

Mr. CAPLIN. Yes.

Chairman PICKLE. Can they do it in a relatively short time?

Mr. CAPLIN. Yes.

Mr. ALEXANDER. I would hope so.

Chairman PICKLE. Commissioner Gibbs today indicated he was going to have such a form out by March 1.

Mr. ALEXANDER. That is real short.

Mr. CAPLIN. He has been working at it for a while.

Chairman PICKLE. I said the first of March or the Ides of March, a week later; within that 2 or 3 weeks, in that neighborhood.

The point I want to make is, we know what the problem is. You don't need more facts and studies. You just have to make a decision. I guess we have to make a decision: Do we want simplicity at the risk of not collecting the right amount of money from individuals? Or do you want to take a chance and give up the simplicity knowing you will have less complaints?

Mr. CAPLIN. If the Commissioner exercises the flexibility of waiving penalties, where he feels good faith efforts have been made to comply, I would move in the direction of simplicity.

Chairman PICKLE. One other thing with respect to the penalties. The IRS has said that they are not going to use penalties and the revenue from them for purposes of carrying out policy or funding IRS services. Yet, in our tax bill, we did allow for a certain amount to go into the budget.

Should the IRS change their policy or should we, the Congress, change that budget change?

Mr. ALEXANDER. You ought to change the budget approach toward penalties, $1,481 million revenue increase in penalties were put into the Treasury's new revenue estimate on the compliance

provisions in the 1986 act, plus, of course, that point that former Commissioner Caplin and I talked about earlier—the belated increase in the substantial underestimate penalty which was a budgetary device.

This is not a good idea. It smacks of a quota system. That is exactly what we don't need.

Chairman PICKLE. If both of you gentlemen would give to the committee, your ideas, particularly Mr. Caplin, for those penalties you would use. We would like to have those suggestions from you. Also if either of you would give us your idea of what should go on the new W–4 form, we would be pleased to receive it in less time than the time we have given to the Commissioner to make his decision. We would need to have it ahead of his decision.

Mr. CAPLIN. May we borrow his staff, Mr. Chairman?

Chairman PICKLE. If you have any suggestions, we would like to have them. We know it is complex.

I personally want to thank both of you because, as Mr. Rangel said, you have maintained your interest in tax collection, tax reform, and service to the public.

I think, Mr. Alexander, you are right. We have to emphasize somehow the need for more money for taxpayer services.

In the budget last year, the Internal Revenue Service indicated that they had budgeted for, I think, 28 million phone calls in taxpayer services. They had estimated they were going to have 28 million calls, but they only had requested money for 22 million. No wonder there will be 6 million people whose calls can't be answered. As a consequence of that, people call and sometimes they will tell us they let the phone ring 20, 30, 40 times and maybe got an answer then if they had not given up.

I always contend as a former PR man, one of the best things the Internal Revenue Service could do would be to beef up taxpayer services and really hire the best smiling, genial, helpful people they can and take the aggressive attitude away by saying, how can we help you, and really meaning it.

But that is difficult from a personnel budget standpoint.

Mr. CAPLIN. Most people want to comply. We tend to focus on the aberrations. There are millions and millions of people out there who really want to report every penny that they have to pay; not that they like it, but they do it for a variety of reasons. We owe it to the public to give them that assistance to help them comply.

Mr. SCHULZE. Mr. Chairman, I would ask, since I was late, that I have unanimous consent to have my opening statement be placed in the record.

Chairman PICKLE. Certainly.

[Mr. Schulze's opening statement follows:]

OPENING STATEMENT OF HON. DICK SCHULZE

Mr. Chairman, I join you in opening the first hearing of the Oversight Subcommittee for the 100th Congress.

The subcommittee's agenda for the year will focus on such important issues as IRS operations; the implementation of tax reform; the activities of tax-exempt organizations; pensions; excise tax compliance; the Caribbean Basin Initiative; and nursing home care. It is a challenging schedule which I am looking forward to tackling. There also is a good likelihood that our various investigations could form the basis for legislative action by the full committee.

The efficiency of IRS operations has been the subject of our hearings in prior years. I am gratified to learn that the abnormally high inventory backlogs and refund delays have been significantly corrected since the problem year 1985. I am anxious to hear the IRS tell us of the steps it has taken to improve its tax return processing operations.

In addition, I want to learn about the IRS's plan for a major overhaul of its computer and information processing system. The dated technology of their current equipment makes replacing it a high priority. However, my concern is that if the IRS has experienced problems in procuring and deploying relatively small modifications to its computer system, then a major procurement may strain its management capability and actually jeopardize its operations.

My attention on the IRS operation is reinforced this year because of the expected strain of implementing tax reform. While the delays and systems problems of 1985 have been reversed, the critical question is whether the service has improved enough to implement tax reform smoothly.

Regretably, the service appears to have started off on the "wrong foot" with the new W-4 withholding certificate. I realize that the requirement to file new W-4 forms stems from section 1581 of the Tax Reform Act of 1986. However I want to learn why the IRS decided to change and expand the form's worksheet for 1987. Also, how can employers and taxpayers cope smoothly with a multiple set of different W-4 forms which appears to be one option under consideration.

I believe it is important to act quickly in straightening out the W-4 form for 1987. In addition to the importance of the form itselp, it symbolizes the need for the IRS to stay in touch with the sensitivity of the average taxpayer in implementing tax reform. If the public reacts to the revised 1040 form as it did to the revised W-4 form, then both the administration and Congress will be stung by their anger.

Mr. Chairman, I join you in welcoming today's witnesses and I look forward to receiving their testimony. In particular I want to welcome the Gentlelady from Maryland the Honorable Connie Morella. She is a gifted public servant whose comments should be very helpful to us.

Mr. SCHULZE. I would like to thank Donald Alexander. His comparison of the committee with castor oil is one of the nicest things that has ever been said about us.

Mr. ALEXANDER. Let the record show that was said 10 years after I left the IRS.

Chairman PICKLE. I want to thank you for sharing your experience and insight with us.

Mr. RANGEL. I didn't mean, Mr. Caplin, to do what so many people do when you raise a problem, to ask you to go back and find the answer; but it would be helpful, based on your experience and especially in talking with your colleague and professional organizations that you belong and the conferences that you attend, that where you find that there is a cluster of criticism on the penalty provisions based on fairness, unfairness and inequities, these are the ones we would rather look at than to review the entire code.

Mr. CAPLIN. The Commissioner has said that he is undertaking a study himself.

Mr. RANGEL. I know. Oversight means that we like to look at the other side of the question as well.

Mr. ALEXANDER. Congressman Rangel, there are real problems out there. Some of the penalties are being applied by certain people in overzealous ways, as you would expect. So there are problem areas. I am sure IRS will address them.

Mr. CAPLIN. I think anybody connected with the system understands that you have to have enforcement tools, you have to have certain penalties. But what I am concerned about is the taxpayer who wants to comply, but who finds himself confronted by an endless list of penalties applicable to each of his tax foot faults. At this point, the whole concept of compliance, voluntary compliance,

changes. It becomes a game. It is a fight. You hit him with this 10, 15, 25 percent penalty. Under such a system, the rules of the road change dramatically.

I will certainly take another look at the problem and hope I can work with Mr. Gibbs on it.

Mr. RANGEL. Thank you.

Chairman PICKLE. I thank the members of the subcommittee for your dedication this morning. Thank you all for your appearance.

Are there any further questions by the subcommittee?

Thank you, and, Mr. Gibbs, we appreciate your cooperation.

The subcommittee will stand adjourned.

[Whereupon, at 1:30 p.m., the hearing was adjourned.]

[The following was submitted for the record:]

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STATEMENT FOR THE RECORD
BY
JAMES I. MURPHY, PRESIDENT
SYSOREX INFORMATION SYSTEMS, INC.

TO THE

SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

I. INTRODUCTION

A. Sysorex Information Systems, Inc.

Sysorex Information Systems, Inc., a subsidiary of Sysorex International, Inc., specializes in the development, installation, and management of large scale computer-based information systems.

Typically, Sysorex' projects involve the specification, design, development, implementation, and on-going support of large telecommunications-based information systems. The technical services provided by Sysorex are supported by comprehensive training programs which are custom tailored to the needs of each client's users and technical staff.

In addition to the Internal Revenue Service, our Government clients include the U.S. Customs Service, the U.S. Mint, the Saudi Arabian Ministry of Defense and Aviation, the Saudi Arabian Department of Customs, and, previously, the Saudi Arabian Ministry of Planning.

The majority of these contracts are comprehensive in scope, nationwide, multi-year, and are in excess of $100 million in value.

Sysorex' experience includes prime contracting; system development; system integration; site planning and

construction; equipment acquisition, installation and maintenance; telecommunications network design and installation; and professional general and system-specific training.

B. CRS Contract Scope

Under its contract with the IRS for the Communication Replacement System/Integrated Data Retrieval System, Sysorex is responsible for providing a variety of computer equipment, software, and services to the IRS and to develop, install, and support a technically advanced, high-capacity, and highly reliable data communications processing system which is to be installed in support of the National Computer Center, the Service Centers, and the various IRS offices throughout the Nation.

The equipment, software, and services that Sysorex is obligated to provide include:

- CRS communications processing computer systems
- Communication network control equipment
- CRS-to-host channel adapters
- Large quantities of IDRS terminals
- Operating systems, language processors, and related systems software
- Real-time and batch processing CRS application software
- Communications network control software (microcode)
- Specialized software for IBM personal computers to operate as IDRS terminals and cluster controllers
- Computer equipment and software maintenance support
- Systems engineering technical support
- Site planning and equipment installation
- Comprehensive system and user documentation
- Terminal user training throughout the IRS
- Comprehensive training of the IRS communication software technical staff
- Specialized software required to interface IBM personal computers to the host computer to facilitate early replacement of high-maintenance terminals

II. CRS System Components

The CRS will be comprised of several types of computer and communications equipment and the systems and applications software required for the system to operate in an integrated environment. The basic system components are discussed below.

A. Communications Processor

The Communications processors will be comprised of two IBM 4381 model 12 processing units configured with eight million bytes of memory and eight data channels. The 4381-12

processors will be complemented by the required quantities of IBM 3380 disk storage units, 3420 magnetic tape units, storage control units, and data channels to provide the alternate pathing and mirrored files required to provide a high availability configuration. Industry surveys show that the IBM 4381 processor's reliability is unsurpassed in the industry.

B. Telecommunications Network Controllers

The communications network control equipment provided to support the CRS is a network controller delivered through and maintained by the IBM Corporation, and manufactured by Potomac Scheduling Company (PSC) of Bethesda, Maryland. Because the PSC equipment is controlled throughout using micro processors, the equipment can be programmed to support multiple types of terminals and communications protocols. This feature permits the PSC equipment to be readily adapted to support new terminal technology and new communications line protocols.

The communications controllers are directly attached to the IBM 4381-12 processors through an IBM block multiplexer channel interface which is also provided by PSC.

C. Host Channel Adapter

The IBM 4381-12 processors are interfaced to the IDRS host processor through a channel-to-channel adapter. The host-channel adapter interfaces to the ISI word channel on the host and to a block multiplexer channel on the IBM 4381. Each CRS to host connection is supported by dual host interfaces so the failure of one unit will not hinder the ability of the CRS to communicate with the host computer. The CRS equipment and software architecture permits the CRS to communicate with multiple host computer systems.

D. IDRS Terminals

The IDRS terminals to be provided under the CRS contract will consist of two models of the IBM personal computer product line in multiple configurations, depending upon the needs of the terminal users located in the various IRS offices. In order to assure compatibility with existing IRS equipment, the IBM PC's employ a special microprocessor controlled circuit board provided by PSC that fits into one of the expansion slots in the chassis of the IBM PC. The specific model and configuration of the PC's to be installed in a given location depend upon whether the location requires a single terminal or a cluster (multiple terminals), requires word processing support, or simply requires access to the IDRS system.

The compatibility of the IDRS terminals with the present IRS terminal environment is key to the present effort to replace the existing high-maintenance terminals.

E. System Software

The CRS is being designed to operate under the IBM Transaction Processing System (TPF). TPF is a proven high-capacity, high-availability control program used by major airlines, hotel chains, financial institutions, and others that require high message throughput, consistently fast response times, and exceptional reliability and availability. A second IBM 4381-12 processor, which serves as a backup and support processor will operate under the IBM Multiple Virtual Storage (MVS) operating system. The MVS

system will be used to maintain the real-time operating system and applications and to produce non-real-time reports.

F. CRS Applications Software

The CRS applications will be comprised of both real-time message switching software and a set of off-line reporting and file maintenance applications software.

1. Real-Time Applicatons

The CRS real-time application software is being designed under a message switching architecture. While the CRS will provide the ability for the terminal network to communicate with the IDRS host computer system, the general design of the system will readily accommodate expanding the ability to communicate with other host computer systems and provide general message switching services. The real-time software will support several critical functions.

a. Network Control

Under the real-time system, the operator will be provided extensive control over the network facilities. The status of terminals, lines, controllers, and other communications devices will be controlled by operator commands. The network control commands will handle network tasks in a manner which allows efficient analysis and correction of network problems. The network control facility will control the network facilities down to the terminal level.

Network statistics will be accumulated and reported which show traffic, error thresholds, and other critical network management data. Provision will be made to produce statistics reports both during real-time operations and on an off-line summary basis.

b. Message Switching and Control

The message switching and control functions of the CRS will be responsible for analyzing each message that enters the system from either a terminal or a host computer system and determine what, if any, processing is to be performed on the message and the destination of the message. If processing, such as security and validation processing, is required, the message will be assigned to the proper application dispatcher for processing. After the required message processing is performed, the message or the response, whichever is appropriate, is routed to its destination.

The application programs which are dispatched to process messages are unique to the functions to be performed. These functions are determined by the contents of the message and the application under which the terminal is signed on.

The message switching function will include end-to-end message accountability. All messages will be saved for re-transmission until they are successfully received at their destination or it

becomes apparent that they cannot be transmitted. In such cases, the user or the console operator, as appropriate, will be notified.

c. Application Level Network Commands

Terminal commands will be provided that:

- Start and end the real-time day
- Activate and deactivate the network
- Change the status of the network resources
- Maintain command code tables
- Maintain terminal network configuration
- Maintain employee files
- Maintain security files and user access to systems and functions
- Create and send broadcast messages
- Transfer files and transcript data between the NCC and the service centers
- Monitor system activity
- Initiate remote console support
- Initiate PSC network equipment diagnostics
- Initiate tape backup of journal files
- Display dumps
- Display multiple screens of output
- Force reloads of PSC controller and terminal equipment.

2. Terminal Software

The IDRS Controller System Software (CSS) provides the IDRS cluster controller functions and supports all file transfers within the terminal cluster.

The IDRS Terminal System Software (TSS) provides the user interface control that allows the IBM PC to be compatible with the current terminals, while delivering the power and flexibility for future IRS requirements.

The Input/Output Driver (IOD) interfaces the PC processes, including CSS and TSS, to the CLC/PC card.

The CLC/PC is a Z80 microprocessor-based card that resides in an expansion slot of the IBM PC terminals and supports the communication interfaces between the CRS and the controller and within the terminal cluster. The CLC/PC hardware is identical in all the PC-ATs and PC-XTs; however, it is loaded either with controller or work station microcode depending on its location in the cluster.

Host FEP Program

The PSC FEP program is a real-time program that executes on the host computer to support the PSC host interface.

III. Current Status of System

Substantial progress has been achieved in the installation of the CRS at the NCC and the Service Centers.

A. Equipment Installation

All computer, communications, and terminal equipment required to support the development, installation, and testing of the CRS at the NCC has been completed.

Sysorex, in cooperation with IRS personnel from the National Office and the Fresno Service Center, has developed a CRS equipment installation, testing, and cutover plan for the Fresno Service Center. This plan should serve as a model for the remaining centers.

B. System Software

All system software required in support of the CRS computer equipment at the NCC has been installed. Portions of the TPF system are undergoing regeneration to reflect the application redesign. The MVS and VM operating systems, which will not undergo any modification, have been in place and operational since July 1986.

C. Network Software

The PSC terminal network software has been operational for several months.

D. Training

The training required is very comprehensive and requires a great deal of course development and instruction related to training the IRS technical staff, the computer operations personnel, and the IDRS terminal operators.

1. Technical Staff

The training program for the IRS technical staff located at the National Office consists of three tracks. They are IBM System 370 Applications programming, MVS, VM, and TPF systems programming, and communications programming.

All of the IRS National Office Technical staff have completed the IBM Systems 370 applications programming courses. The systems programming and communication programming courses are not scheduled to begin until after the CRS has been installed throughout the IRS.

2. Computer Operators

The computer operators at the National Computer Center and the Fresno Service Center have been trained in both TPF and MVS operations. These courses will be repeated to address the differences introduced by the redesign and to provide refresher training required because of the delay in installing the system.

3. Terminal Operators

Terminal operator training has been completed at the National Office and the National Computer Center. Substantial training has been completed at the Fresno Service Center and will resume on March 18, 1987 to prepare for the early terminal replacement effort.

E. Site Planning

The site plans for all ten service centers and the NCC have been completed and formally approved by the IRS Project Manager and the management at each service center. The site plans for all of the district offices and the remote offices to be connected to the Fresno service center have also been approved. We are presently in the process of installing cable in the Western Region facilities in support of the early replacement of the high-maintenance terminals.

IV. Work-in-Progress

A. CRS Application Software Redesign

The Sysorex proposal to redesign and develop the CRS application has been accepted by the IRS and significant progress has been made since December 15, 1986 when the effort was undertaken.

B. Quality Assurance Plan

The initial and revised drafts of the quality assurance plan have been submitted to the IRS for review and comments. The quality assurance plan stresses a significant degree of IRS involvement throughout the system development cycle, beginning with the initial specification stage and continuing through the integration and acceptance testing phases.

C. Technical Staff

Sysorex has assembled a high-level technical staff to design and develop the CRS application software. Without exception, all of the real-time applications development staff are highly experienced TPF applications programmers who have between five and fifteen years of heavy TPF applications development experience. The average level of experience of the TPF staff is approximately seven years in real-time applications development under TPF in addition to their other programming experience. The experience level of the off-line, or batch, application development staff is comparable to the TPF personnel.

D. Project Planning

The major milestones which must be achieved throughout the development and implementation of the CRS have been specified and reviewed with the IRS project management. Work is currently underway on a detailed project schedule for the entire project that includes system design, system development, integration testing, acceptance testing, training, site preparation, equipment installation, and cutover at the Fresno Service Center. Upon validation of the Fresno installation and cutover model, the project plan will be extended to include all of the service centers. This planning and scheduling is a joint effort between Sysorex and the IRS project management personnel with input from our subcontractors and the IRS regional office and service center representatives.

The project schedules are maintained using an automated critical path scheduling system that is common to Sysorex, the IRS, and IBM. The automated system schedules the various activities which must be completed, tracks progress against the plan based upon periodic progress updates, indicates where attention is required to maintain the completion schedule, and serves as a record of our performance against the project plan.

Our present plan calls for completion of the software design, development, and integration efforts by June 15, 1987 with the IRS system acceptance test to begin immediately thereafter.

Sysorex formally reports progress to the IRS on a weekly basis through joint management meetings. In the meetings, Sysorex provides a written status report and an updated project schedule to the IRS.

E. Training

The majority of the materials development for the training program are complete for the first phase of the program and the staff is currently preparing to teach the following courses.

- Fresno terminal operator training is scheduled to begin on March 18, 1987.
- Computer Systems Analyst (CSA) training is scheduled to begin on May 11, 1987.
- Computer Operator training will be repeated at the NCC, beginning June 1987.

F. Early Terminal Replacement

During the time when the CRS application software is being redesigned, we are proceeding with the early replacement of certain existing high-maintenance terminals. Upon completion of the acceptance testing, we will begin replacing the terminals throughout the IRS on a region by region basis. The replacement will be accomplished in a controlled fashion to assure minimum loss of productivity of the IRS staff.

The replacement of the terminals will benefit the IRS through significantly increased reliability and the associated reduction in maintenance costs.

V. Closing Comment

Sysorex is pleased to have been selected to furnish the CRS/IDRS system to the IRS and remains committed to the timely delivery of a system complying in all respects with its contractual obligations.

February 12, 1987